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The International Comparative Legal Guide to:

Lending & Secured Finance 2019

7th Edition

A practical cross-border insight into lending and secured finance

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EDITORIAL

Welcome to the seventh edition of *The International Comparative Legal Guide to: Lending & Secured Finance*.

This guide provides corporate counsel and international practitioners with a comprehensive worldwide legal analysis of the laws and regulations of lending and secured finance.

It is divided into three main sections:

Three editorial chapters. These are overview chapters and have been contributed by the LSTA, the LMA and the APLMA.

Twenty-five general chapters. These chapters are designed to provide readers with an overview of key issues affecting lending and secured finance, particularly from the perspective of a multi-jurisdictional transaction.

Country question and answer chapters. These provide a broad overview of common issues in lending and secured finance laws and regulations in 51 jurisdictions.

All chapters are written by leading lending and secured finance lawyers and industry specialists and we are extremely grateful for their excellent contributions.

Special thanks are reserved for the contributing editor Thomas Mellor of Morgan, Lewis & Bockius LLP for his invaluable assistance.

Global Legal Group hopes that you find this guide practical and interesting.

The *International Comparative Legal Guide* series is also available online at www.iclg.com.

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PREFACE

Welcome to the 2019 edition of *The International Comparative Legal Guide to: Lending & Secured Finance*. Morgan, Lewis & Bockius LLP is delighted to serve as the Guide's Contributing Editor.

The *Guide*'s first six editions established it as one of the most comprehensive guides in the practice of cross-border lending. This seventh edition includes contributions from the LSTA, the LMA and the APLMA, covers 51 jurisdictions and includes numerous overview chapters written by leading practitioners. In addition, we are delighted to once again include in-house counsel from HSBC to this seventh edition. The participation of in-house counsel at a global financial institution provides a valuable additional perspective for the *Guide*'s users.

We hope you find the *Guide* useful, and we encourage you to contact us with suggestions to improve future editions.

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Loan Syndications and Trading: An Overview of the Syndicated Loan Market

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Loan Syndications and Trading Association

In the past 30 years, the art of corporate loan syndications, trading, and investing has changed dramatically. There was a time when banks lent to their corporate borrowers and simply kept those loans on their books, never contemplating that loans would be traded and managed by investors like stocks and bonds in a portfolio. In time, however, investors became drawn to the attractive features of loans. Unlike bonds, loans were senior secured debt obligations with a floating rate of return, and, over the years, an institutional asset class emerged. Today, such loans are not only held by banks but are also typically sold to other banks, mutual funds, insurance companies, structured vehicles, pension funds, and hedge funds. This broader investor base has brought a remarkable growth in the volume of loans being originated in the primary market and subsequently traded in the secondary market. The syndicated loan market represents one of today's most innovative capital markets.

In 2018, total corporate lending in the United States surpassed $2.6 trillion.[1] This figure encompasses all three subsectors of the syndicated loan market – the investment grade market, the leveraged loan market, and the middle market. In the investment grade market, total lending exceeded $1 trillion in 2018. Most lending in the investment grade market consists of revolving credit facilities to larger, more established companies. The leveraged loan market, where loans are made to companies with non-investment grade ratings (or with high levels of outstanding debt), represented approximately $1.2 trillion.[2] Leveraged loans are typically made to companies seeking to refinance existing debt, to finance acquisitions or leveraged buyouts, or to fund projects and other corporate endeavours such as dividend recapitalisations. Leveraged loans comprise the overwhelming majority of loans that are traded in the secondary market. Then there is the middle market. As traditionally defined, middle market lending includes loans of up to $500 million that are made to companies with annual revenues of under $500 million.[3] For these companies, the loan market is a primary source of funding. In 2018, overall middle market lending totalled approximately $365 billion.[4]

Of these three market segments, it is the leveraged loan market that has evolved most dramatically over the past 30 years. Attracted by the higher returns of the loan asset class, the investor base expanded significantly starting from the mid-1990s and has grown increasingly more diverse. This, in turn, fuelled demand for loans, leading to a commensurate rise in loan origination volumes in the primary market. For the loan market to grow successfully, for the loan asset class to mature, and to ease the process of trading and settlement, the new entrants to the market in the 1990s needed uniform market practices and standardised trading documentation. In response to these needs, the Loan Syndications and Trading Association ("LSTA" or "Association") was formed in 1995, and its mission since inception has included the development of best practices, market standards, and trading documentation. The LSTA has thus successfully spearheaded efforts to increase the transparency, liquidity, and efficiency of the loan market; in turn, this more standardised loan asset class has directly contributed to the growth of a robust, liquid secondary market.

The LSTA's role has expanded to meet new market challenges, assuming more prominence in the loan market generally and, particularly in recent years, the LSTA has regularly engaged with the U.S. government and its regulatory bodies on legislative and regulatory initiatives. Policymaking in the wake of the financial crisis had included sweeping changes to the financial industry, including to the loan market, even though the regulatory impact on the loan market was sometimes an unintended byproduct of reform legislation aimed somewhere else. The LSTA has, therefore, dedicated substantial time and energy over the past decade to building awareness amongst regulators about the loan market and how it functions, seeking to distinguish it from other markets and, at times, persuading policymakers to exempt the loan market from particular legislative measures.

Having established a more mature regulatory outreach programme, the LSTA now maintains a dialogue about the loan market with regulators and promoting the many benefits of a vibrant leveraged loan market for U.S. companies.

This chapter examines: (i) the history of the leveraged loan market, focusing on the growth and maturation of the secondary trading market for leveraged loans; (ii) the role played by the LSTA in fostering that growth through its efforts to standardise the practices of, and documentation used by participants active in, the secondary loan market to bring greater transparency to the loan asset class; and (iii) the regulatory challenges faced by the loan market.

Growth of the Secondary Market for Leveraged Loans

The story of the leveraged loan market starts about 30 years ago in the United States, with the first wave of loan market growth being driven by the corporate M&A activity of the late 1980s. Although a form of loan market had existed prior to that time, a more robust syndicated loan market did not emerge until the M&A deals of the 1980s and, in particular, those involving leveraged buy-outs (LBOs), which required larger loans with higher interest rates. This had two significant consequences for the loan market. First, because banks found it difficult to underwrite very large loans on their own, they formed groups of lenders – syndicates – responsible for sharing the funding of such large corporate loans. Syndication enabled the banks to satisfy market demand while limiting their own risk exposure to any single borrower. Second, the higher interest rates associated with these large loans attracted non-bank lenders to the loan market, including traditional bond and equity investors, thus creating a new demand stream for syndicated loans. Retail mutual funds also entered the market at this time and began to structure their funds for the sole purpose of investing in bank loans. These loans generally were senior secured obligations with a floating interest rate. The resultant asset class had a favourable risk-adjusted return profile. Indeed, a non-bank appetite for syndicated leveraged loans would be the primary driver of demand that helped propel the loan market's growth.[5]

Although banks continued to dominate both the primary market (where loans are originated) and the secondary market (where loans are traded), the influx of the new lender groups in the mid-1990s saw an inevitable change in market dynamics within the syndicated loan market. In response to the demands of this new investor class, the banks, which arranged syndicated loans, began modifying traditional deal structures, and, in particular, the features of the institutional tranche or term loan B, that portion of the deal which would typically be acquired by the institutional or non-bank lenders. The size of these tranches was increased to meet (or create) demand, their maturity dates were extended to suit the lenders' investment goals, and their amortisation schedules tailored to provide for only small or nominal instalments to be made until the final year when a large bullet payment was scheduled to be made by the borrower. In return, term loan B lenders were paid a higher rate of interest. All these structural changes contributed to a more aggressive risk-return profile, which was necessary in order to still attract more liquidity to the asset class.

A true secondary market for leveraged loans in the United States emerged in the 1990s. During the recession of the early 1990s, default rates rose sharply, which severely limited the availability of financing, particularly in transactions involving financing from regional and foreign banks. Interest rates to non-investment grade borrowers thus increased dramatically. Previously, banks had carried performing loans at par or face value on their balance sheets, while valuations below par (expected sale prices) were only generally assigned to loans that were in or near default. During the credit cycle of the early 1990s, however, a new practice developed in the banking industry. As banks in the U.S. sought to reduce their risk and strengthen their balance sheets, they chose to sell those leveraged loans which had declined in value since their syndication, rather than hold the loans until their maturity date as they had in the past. In so doing, a new distressed secondary market for leveraged loans emerged, consisting of both traditional (bank) and non-traditional (non-bank) buyers. Banks were not simply originators of these loans but now were also loan traders, and thus, in their role as market makers, began to provide liquidity for the market.

Although leveraged lending volume in the primary market had reached approximately $100 billion by 1995, trading activity was still relatively low, standing at approximately $40 billion.[6] The early bank loan trading desks at this time initially acted more as brokers than traders, simply brokering or matching up buyers and sellers of loans. As liquidity improved and the lender base expanded, investors began to look to the secondary market as a more effective platform from which to manage their risk exposure to loans, and eventually active portfolio management through secondary loan trading was born. With the advent of this new and vibrant secondary loan market, there naturally was a greater need for standard trading documents and market practices which could service a fair, efficient, liquid, and professional trading market for commercial loans – a need reflected in the LSTA's creation in 1995. (The LSTA and its role in the development of a more standardised loan market are discussed more fully below, under "The Standardisation of a Market".)

Around the same time, the loan market acquired investment tools similar to those used by participants in other mature markets; for example, a pricing service, bank loan ratings, and other supporting vendor services. In 1996, the LSTA established a monthly dealer quote-based secondary mark-to-market process to value loans at a price indicative of where those loans would most likely trade. This enabled auditors and comptrollers of financial institutions that participated in secondary trading to validate the prices used by traders to mark their loan positions to "market". Within a few years, however, as leveraged lending topped $300 billion and secondary trading volume reached $80 billion, there was a need to "mark-to-market" loan positions on a more frequent basis.[7] In 1999, this led to the LSTA and Thomson Reuters Loan Pricing Corporation jointly forming the first secondary mark-to-market pricing service run by an independent third party to provide daily U.S. secondary market prices for loan market participants. Shortly thereafter, two other important milestones were reached, both of which facilitated greater liquidity and transparency. First, the rating agencies began to make bank loan ratings widely available to market participants. Second, the LSTA and Standard & Poor's together created the first loan index, the S&P/LSTA Leveraged Loan Index (LLI), which has become the standard benchmarking tool in the industry. Just as the market's viability was on the rise, so was its visibility. In 2000, the Wall Street Journal began weekly coverage of the syndicated loan market and published the pricing service's secondary market prices for the most widely quoted loans. All these tools – the pricing service, the bank loan ratings, the loan index, and the coverage of secondary loan prices by a major financial publication – were important building blocks for the loan market, positioning it for further successful growth.

At about this time, the scales tipped, and the leveraged loan market shifted from a bank-led market to an institutional investor-led market comprised of finance and insurance companies, hedge, high-yield and distressed funds, loan mutual funds, and structured vehicles such as collateralised loan obligations or "CLOs". Between 1995–2000, the number of loan investor groups managing bank loans grew by approximately 130 per cent and accounted for more than 50 per cent of new deal allocations in leveraged lending. By the turn of the millennium, leveraged lending volume was approximately $310 billion and annual secondary loan trading volume exceeded $100 billion as illustrated in the chart below. With these new institutional investors participating in the market, the syndicated loan market experienced a period of rapid development that allowed for impressive growth in both primary lending and secondary trading.

Unfortunately, as the credit cycle turned and default rates increased sharply in the early 2000s, there was a temporary lull in the market's growth, with secondary loan trading stalled for a number of years. By 2003, however, leveraged lending (and trading) volumes quickly rebounded as investor confidence was restored.

Even the most bullish of loan market participants could not have predicted the rate of expansion that would take place over the next four years. Once again, this growth was driven by M&A activity and large LBOs. Increasing by nearly 200 per cent from 2003–2007, leveraged loan outstandings were more than half a trillion dollars and secondary trading volumes reached $520 billion. Although hedge funds, loan mutual funds, insurance companies, and other investor groups played a large part in this phase of the loan market's expansion, the growth had only been possible because of the emergence of CLOs. This structured finance vehicle changed the face of the leveraged loan market and was also responsible for its revival after the Global Financial Crisis.

The 2008 Global Financial Crisis led to a recession in the United States, a contraction of global supply and demand, and record levels of default rates. Several years passed before leveraged lending issuance was restored to pre-crisis levels, finally reaching $665 billion in 2012. Although secondary trading activity had been in steady decline from 2008 through 2012, the asset classes' investment thesis (senior secured, floating rate, high risk-adjusted return) coupled with the investment tools put in place years earlier and the standardisation of legal and market practices helped the market to expand further during its next phase which began in 2013. Since 2013, annual secondary loan trade volumes have grown almost without interruption, reaching a record $720 billion in 2018.

The Standardisation of a Market

No regulatory authority directly oversees or sets standards for the trading of loans in the United States, although, of course, loan market participants themselves are likely to be subject to other governmental and regulatory oversight. Instead, the LSTA leads the loan market by developing policies, guidelines, and standard documentation and promoting just and equitable market practices. The LSTA's focus is attuned to the distinctive structural features of the loan market which stem from the fact that corporate loans are privately negotiated debt obligations that are issued and traded subject to voluntary industry standards. Because the LSTA represents the interests of both the sellers and buyers of leveraged loans in the market, it serves as a central forum for the analysis and discussion of market issues by these different market constituents and thus is uniquely placed to balance their needs and drive consensus.

Loan market participants have generally adopted the standardised documents and best practices promulgated by the LSTA. The LSTA is active in the primary market, where agent banks originate syndicated loans, and in the secondary market, where loan traders buy and sell syndicated loans. The LSTA has an ever-growing library of documents for use in the primary market, including a new form of a complete credit agreement for investment grade borrowers which was published in 2017, all of which are generally used by market participants. Over the years, the Association has published a suite of standard trading documents: forms or "trade confirmations" are available to evidence oral loan trades made by parties and form agreements are available to document the terms and conditions upon which the parties can settle those trades. The universal adoption of the LSTA's standard trading documents by the market has directly contributed to the growth of a robust, liquid secondary market.

It is customary for leveraged loans to be traded in an over-the-counter market, and, in most instances, a trade becomes legally binding at the point the traders orally agree the material terms of the trade. Those key terms are generally accepted as including the borrower's name, the name, facility type, and amount of the loan to be sold, and the price to be paid for the loan. For commercial reasons, most U.S. borrowers choose New York law as the law governing their credit agreements, and for similar reasons, the LSTA has chosen New York as the governing law in their trading documentation. Since 2002, loan trades agreed over the telephone, like agreements relating to derivatives contracts and certain other financial instruments, have benefited from an exemption from a New York law which would otherwise require them to be set forth in a signed writing to be enforceable. Because of the LSTA's lobbying efforts, the applicable New York law was changed in 2002 to facilitate trading. Thus, provided both parties have traded together previously on LSTA standard documentation, even if one party fails to sign a confirmation evidencing the terms of the trade, the loan trade will be legally binding and enforceable, if it can be shown that the parties orally agreed the material trade terms. This was a critical legislative reform that contributed to legal certainty in the loan market and harmonised its status with that of other asset classes.

After agreeing the essential trade terms, loan market practice requires that parties then execute a form of LSTA trade confirmation (the legislative change discussed above merely makes it possible legally to enforce an oral trade even if a confirmation has not been signed). Loans can be traded on what is referred to as par documentation or on distressed documentation. Two forms of trade confirmations are available for this purpose and the choice of which one to use is a business decision made at the time of trade. Performing loans, where the borrower is expected to pay in full and on a timely basis, are typically traded on par documentation which means that the parties evidence their binding oral trade by executing an LSTA Par Confirmation and then settling the trade by completing the form of Assignment Agreement provided in the relevant credit agreement (the term par is used because performing loans historically traded at or near par). Alternatively, where a borrower is in, or is perceived to be in, financial distress or the market is concerned about its ability to make all interest payments and repay the loan in full and on a timely basis, parties may opt to trade the borrower's loans on distressed documentation. In this case, the trade is documented on an LSTA Distressed Confirmation, and the parties settle the transaction by executing the relevant assignment agreement and a supplemental purchase and sale agreement. The LSTA has published a form agreement for this purpose which has been refined over the years and is generally used by the market. This agreement includes, amongst other provisions, representations and warranties, covenants, and indemnities given by seller and buyer. The adoption of standard documents in this regard, particularly for distressed debt trading, significantly contributed to a more liquid loan market, for market participants, knowing that an asset is being traded repeatedly on standard documents, can then uniformly price the loan and more efficiently settle the trade.

When a loan is traded, the existing lender of record agrees to sell and assign all of its rights and obligations under the credit agreement to the buyer.[8] In turn, the buyer agrees to purchase and assume all of the lender's rights and obligations under the credit agreement. The parties must then submit their executed assignment agreement to the administrative agent which has been appointed by the lenders under the credit agreement. The borrower's and agent's consent is typically required before the assignment can become effective. Once those consents are obtained, the agent updates the register of lenders, and the buyer becomes a new lender of record under the credit agreement and a member of the syndicate of lenders.[9]

If, for some reason, the borrower does not consent to the loan transfer to the buyer, the parties' trade is still legally binding under the terms of the LSTA's Confirmation and must be settled as a participation.[10] The LSTA has published standardised par participation agreements and distressed participation agreements which may be used to settle par and distressed trades, respectively, where loan assignments are not permissible. Under this structure, the seller sells a 100 per cent participation interest in the loan to the buyer and retains bare legal title of the loan. Although the seller remains a lender of record under the credit agreement and the borrower will not typically be aware that a participation interest in the loan has been sold, the seller must pass all interest and principal payments to the buyer for so long as the participation is in place. The transfer of a participation interest on LSTA standard documents is typically afforded sale accounting treatment under New York law. Thus, if the seller of the participation becomes a bankrupt entity, the participation is not part of the seller's estate, and the seller's estate will have no claim to the participation or the interest and principal payments related thereto.

The LSTA continues to expand its suite of trading documents and has increasingly played a more active role in the primary market. Building on the publication of the second edition of *LSTA's Complete Credit Agreement Guide* in 2017, the LSTA released its first form of a complete credit agreement, an unsecured revolving credit facility designed to be used by investment grade borrowers, and is currently working on a leveraged credit facilities term sheet and then will release its complete credit agreement for leveraged finance transactions. Finally, the LSTA continues to expand its suite of documents for making, trading, and settling loans to borrowers domiciled in certain jurisdictions in Latin America, releasing documents for use with borrowers in Mexico in 2018.

Leaving LIBOR and Going Green? A Look at 2019 and Beyond

Looking back at 2018, two topics grabbed the attention of market participants: first, the potential phase-out of LIBOR and preparations for the transition to replacement benchmarks; second, on a more positive note, the U.S. introduced the first sustainable syndicated loan products, joining the likes of many countries in EMEA and APAC.

After the UK's Financial Conduct Authority, the regulator of ICE LIBOR, announced in 2017 that panel banks have only agreed to submit quotes through 2021, loan markets across the globe have grappled with the uncertainty that LIBOR will continue to be the prevailing benchmark of the financial markets. A transition to a new benchmark, particularly for legacy transactions, is a big undertaking and a smooth transition will certainly require participation and collaboration from all market participants. To help coordinate the U.S. loan market in this process, the LSTA co-chairs the business loans working group organised by the U.S. Federal Reserve-sponsored Alternative Reference Rates Committee (ARRC). The ARRC is tasked with spearheading the transition away from LIBOR across asset classes. There is much work to be done in the coming years, but it has been seen as most important to ensure that new financial instruments have fallback language to address a LIBOR discontinuance. To that end, in 2018 the ARRC released market consultations on fallback language for syndicated loans and bilateral loans. This market feedback will be used to refine the proposed fallback language and the ARRC will publish a final recommendation in 2019. Another area of great focus is the operational changes to market participants' systems that will be required for the new benchmark. 2019 (and beyond) will see much attention in this area as well as a heightened focus on the development of term rates for SOFR, the presumed successor to USD LIBOR, and the development of a spread adjustment to make SOFR more comparable to LIBOR.

At the same time as concerns over LIBOR's robustness have led to the possible phase-out of the ubiquitous benchmark, separately, we have seen environmental and sustainability considerations find their way into nearly all aspects of our consciousness—whether at a corporate or individual level. This is clearly reflected in the observed increase in sustainable finance. While the majority of activity in this space has been on the equities side, the fixed income markets have also seen the development of green and sustainable products. The global volume of green and sustainability transactions has grown, as has the standardisation around these products. On the loan side, 2018 was a landmark year. The Americas saw their first green loans—and on the heels of that activity, the LSTA, along with the Loan Market Association (LMA) and Asia Pacific Loan Market Association (APLMA), published global Green Loan Principles (GLP). In addition, the first sustainability-linked loans emerged in the U.S.

Green loans build on the success of green bonds, which are use of proceeds bonds that align with certain transparency and reporting components. Both green bonds and green loans look to facilitate and support environmentally sustainable activity by offering financing for one or more eligible green projects. The Green Bond Principles (GBP), maintained by the International Capital Market Association, are internationally recognised voluntary issuance guidelines that promote transparency, disclosure and reporting in the green bond market. As financial market participants have grown to recognise the GBP and a standard green bond, the development of green loans as an alternative financing option has been a natural evolution. The GLP build on and refer to the GBP to ensure consistency across both products. The GLP adopt the same four core components as the GBP: 1) the proceeds of the loan are used to finance "green projects" as described in the GLP; 2) the borrower has developed a process for green project evaluation and selection; 3) the borrower manages and tracks the use of the loan proceeds; and 4) the borrower makes and keeps available up-to-date information on the use of proceeds. The GLP also include a recommendation for an external review, where appropriate. These core components together promote transparency, disclosure and reporting, which in turn lends integrity to the green loan product.

While green loans have the advantage of kinship with green bonds – a well-known and booming product – the necessary linkage of their proceeds with *projects* can prove challenging in the context of the corporate loan market. Many corporate loans are used for general corporate purposes. In light of this reality, a separate product has emerged. Sustainability-linked loans are loans where the borrower is incentivised, typically through loan pricing, to meet predetermined sustainability performance targets. Unlike green loans, the use of loan proceeds is not a factor. If a borrower meets the predetermined target, there is a discount in the borrower's cost of borrowing (or a premium if the borrower fails to meet the target). In this way, sustainability-linked loans represent one of the most direct ways of incentivising a borrower to improve its sustainability profile. Through the setting of meaningful performance targets, lenders can make a real impact in motivating companies—whether those borrowers are already leaders in sustainability or just beginning to work toward sustainable goals. The LSTA, LMA and APLMA are developing a voluntary framework to address these important loans. Like the GLP, this framework will have the advantage of being a global standard, but the core components are necessarily different. In the context of sustainability-linked loans, attention must be paid to how performance targets are set in each transaction, as well as ensuring sufficient transparency to lenders with respect to this performance through reporting and external review, where appropriate. It is the hope that this next framework will provide standardisation and growth while protecting the integrity of sustainability-linked loans.

Conclusion

The U.S. corporate loan market continues to evolve and expand, continually adapting to new challenges, including legal, regulatory, and economic challenges. In this environment, the LSTA remains committed to promoting a fair, efficient, and liquid market for loans and maintaining its position as the market's principal advocate. Looking forward, the loan market will see continued, and perhaps even increased, focus on the phase-out of LIBOR and sustainable lending. Both are areas where the LSTA hopes to be of service to its membership and the broader loan market. The LSTA will continue to provide leadership on the transition to replacement benchmarks through its work on the ARRC. Likewise, the LSTA hopes to encourage the growth of sustainable loan products as well as preserve flexibility and foster innovation in this dynamic space. To this end, the LSTA will continue to offer voluntary standard frameworks, where appropriate, as well as educate loan market participants on sustainable lending.

Endnotes

1. Thomson Reuters Loan Pricing Corporation.
2. Thomson Reuters Loan Pricing Corporation. "Leveraged" is normally defined by a bank loan rating by Standard & Poor's of BB+ and below (by Moody's Investor Service, Ba1 and below) or, for non-rated companies, typically an interest rate spread of LIBOR + 125 basis points.
3. For a more detailed description on the loan market sectors, see Peter C. Vaky, Introduction to the Syndicated Loan Market, in *The Handbook Of Loan Syndications & Trading*, 39 (Allison Taylor and Alicia Sansone, eds., 2007); Steve Miller, Players in the Market, in *The Handbook Of Loan Syndications & Trading*, *supra*, 47.
4. Thomson Reuters Loan Pricing Corporation.
5. For a more detailed description of the history of the loan market, see Allison A. Taylor and Ruth Yang, Evolution of the Primary and Secondary Leveraged Loan Markets, in *The Handbook Of Loan Syndications & Trading*, *supra*, 21.
6. Thomson Reuters Loan Pricing Corporation.
7. Thomson Reuters Loan Pricing Corporation.
8. For a detailed comparison of assignments and participations, see Michael Bellucci and Jerome McCluskey, *The LSTA's Complete Credit Agreement Guide*, 2nd ed., 541–542 (McGraw-Hill 2016).
9. For further information on the structure of assignments, see *id*. at 543–561.
10. For further information on the structure of participations, see *id*. at 561–567.

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Tess Virmani is Senior Vice President & Associate General Counsel of the Loan Syndications and Trading Association (LSTA). Ms. Virmani works with the LSTA's Primary Market Committee and Trade Practices and Forms Committee on legal projects for the development, standardisation and revision of the LSTA's documentation and is also involved in resolving secondary loan market trading disruptions. In addition, Ms. Virmani leads the LSTA's Green Loans and Sustainable Loan working group. Ms. Virmani participates in the LSTA's advocacy efforts, including engagement with regulators and working on industry solutions to address market developments, such as the transition to alternative benchmarks.

Prior to joining the LSTA, Ms. Virmani practised as a finance attorney at Skadden, Arps, Slate, Meagher & Flom LLP in New York. She received a B.S. from the Walsh School of Foreign Service at Georgetown University and a J.D. from Fordham University School of Law. She is admitted as an attorney in New York.

LSTA

Since 1995, the Loan Syndications and Trading Association has been dedicated to improving liquidity and transparency in the floating rate corporate loan market. As the principal advocate for this asset class, we aim to foster fair and consistent market practices to advance the interest of the marketplace as a whole and promote the highest degree of confidence for investors in floating rate corporate loans. The LSTA undertakes a variety of activities to foster the development of policies and market practices designed to promote just and equitable marketplace principles and to encourage coordination with firms facilitating transactions in loans and related claims. For more information, please visit www.lsta.org.

Loan Market Association – An Overview

Nigel Houghton

Hannah Vanstone

Loan Market Association

Loan Market Association

Founded in late 1996, the Loan Market Association ("LMA") is the trade body for the syndicated loan market in Europe, the Middle East and Africa ("EMEA").

The LMA's principal objective is to foster liquidity in the primary and secondary loan markets, a goal which it seeks to achieve by promoting efficiency and transparency, by the establishment of widely accepted market practice and by the development of documentation standards. As the authoritative voice of the syndicated loan market in EMEA, the LMA works with lenders, law firms, borrowers and regulators to educate the market about the benefits of the syndicated loan product, and to remove barriers to entry for new participants.

The purpose of this chapter is to give the reader insight into the background and development of the LMA, the scope of its work, and recent and current initiatives.

Background to the LMA

Banks have bought and sold loans for decades but standard market practice is still relatively recent.

Growth in borrowing requirements in the 1970s had seen loan facilities traditionally provided on a bilateral basis, increasingly replaced by larger credit lines from a club of lenders, and then by loan facilities syndicated to the wider market. In the US in the 1980s, a more formal secondary market evolved in parallel with demand on banks' balance sheets and into the 1990s also with the proliferation of non-bank lenders hungry for assets. Proprietary loan trading began to increase and crossed the Atlantic into Europe initially via London-based units of US banks.

By the mid-'90s, the secondary market in Europe had itself evolved to become of increasing importance to banks looking to manage their loan book more proactively, be it for single client exposure reasons, return on equity or otherwise. Proprietary trading added to its growing relevance. Despite this, it was evident to practitioners that the market, as it was at the time, lacked any standard codes of practice, and was inefficient and opaque. In response, a group of banks agreed to form a market association tasked with promoting transparency, efficiency and liquidity and, in late 1996, the LMA was formed.

Initial Focus and Development

Within a few years of inception, the LMA had introduced standard form secondary trade documentation for performing loan assets and distressed debt, proposed standard settlement parameters and built out a contributor-based trading volume survey. Based on the success of the Association's secondary market initiatives, its remit was then broadened to cover primary, as well as secondary, loan market issues.

Just two years after it was founded, LMA membership had grown from an initial seven founding bank practitioners to over 100 institutions. Steady growth since then has seen the membership base expand to 711 in 2018, including banks, non-bank institutional investors, law firms, ratings agencies and service providers from 62 countries.

The evolution of the market from the mid-'90s to today and the requirements of its increasingly diverse membership have seen the LMA's work become broadly subdivided into the following categories:

- Documentation.
- Market practice and guidelines.
- Advocacy and lobbying.
- Education and events.
- Loan operations.

An overview of each category, a brief market overview and outlook summary are given below.

Documentation

From secondary to primary

Following widespread adoption of the LMA's secondary trade documentation as the European market standard, focus was turned to primary documentation. A recommended form of primary documentation was developed by a working party which included LMA representatives and those of the UK-based Association of Corporate Treasurers ("ACT"), the British Bankers' Association ("BBA"), as well as major City law firms, with documents first launched in 1999. Involvement of the ACT and BBA from the outset played a major role in achieving broad acceptance of the LMA recommended forms among borrowers and lenders alike. This success was complemented by the subsequent addition of other forms of primary documentation, including a mandate letter and term sheet.

Following the English law recommended forms in terms of format and style, French law (2002) and German law (2007) versions of investment grade primary documentation were later developed, further broadening general acceptance of LMA standards.

From corporate to leveraged and beyond

The increasing importance of the European leveraged loan market in the early 2000s saw the Association also focus on the development of standardised leveraged loan documentation, with recommended forms agreed in early 2004.

All proposed forms of documentation produced by the LMA are to be regarded as a starting point for negotiations, with the expectation that the more complex the transaction, the more tailoring will be required. This notwithstanding, the fact that all documents have been developed after extensive consultation with market practitioners has led to the recommended documents being viewed as a robust framework upon which to base subsequent individual negotiations. This is particularly true of the leveraged document, where significant input was also sought from non-bank investors within the membership via an institutional investor committee.

As the financial crisis of 2007 began to bite, work commenced on a recommended form of intercreditor agreement, a document generally bespoke to the structure of each transaction. Launched in 2009, the document met with market-wide acclaim again as a robust framework and as the product of comprehensive discussion by market practitioners. As the leveraged market evolved post-crisis, so did the suite of LMA template documents. 2013 saw the launch of an intercreditor agreement and super senior revolving credit facility for use in conjunction with a high yield bond. These were complemented in 2014 with a second super senior intercreditor agreement, for use alongside a super senior RCF, senior secured note and high yield note structure.

Historically, the LMA's principal focus has been on documentation relating to corporate investment grade and leveraged loans, alongside a full suite of secondary loan trading documentation. However, in recent years, and in response to member demand, the association has significantly expanded its coverage, both from a product and geographical perspective, the latter particularly with developing markets in mind.

In 2012, a commercial real estate finance document for multi-property investment was launched, as well as a facility agreement for developing markets and a pre-export finance facility agreement. 2013 saw the launch of a single property development finance facility agreement and four further facility agreements intended for use in developing markets transactions. The LMA continued to expand its suite of documentation in these areas in 2014, with the publication of a real estate finance intercreditor agreement, also facility agreements for use in South Africa, Kenya, Tanzania, Uganda and Nigeria.

In early 2014, the Association published a guide to *Schuldschein* loans, the result of extensive collaborative work by a working party based in Germany. Appropriately the guide was published in German with an English translation. An updated version was published in August 2016.

Following positive feedback from members on the Schuldschein project and in response to member demand, work commenced on the production of a standard form private placement document, with documents in both loan and note format launched in January 2015. The project benefitted from the involvement of the International Capital Market Association ("ICMA") and the ACT. This provided valuable input particularly on the note format (developed in coordination with ICMA) and on borrower/issuer concerns (in the case of the ACT).

The LMA initiative is a significant contribution to the development of a European private placement market particularly when seen in the context of the current work of the Pan-European Private Placement Working Group coordinated by ICMA, which also includes the Euro PP Working Group (composed of all relevant professional organisations and participants in the French market). The Euro PP Working Group has also produced French law private placement documents to complement the French Charter for Euro Private Placements released in 2014.

2015 saw the publication of a term sheet for use in pre-export finance transactions, a secured single currency term facility agreement governed by South African law and a real estate finance German law facility agreement. Later that year, the LMA published a recommended form of clause for inclusion in non-EU law governed facility agreements to the extent required by Article 55 of EU Directive 2014/59, the Bank Recovery and Resolution Directive. This included the production of an EU bail-in legislation schedule, which is referred to in the bail-in clauses of the LMA, LSTA, APLMA and ICMA.

2016 releases included a new security agreement and contractually subordinated intercreditor agreement for use in real estate finance, a German-language German law facility agreement and term sheet for multi-property real estate transactions and an insurance broker letter also for use in real estate finance.

In 2017, the LMA further expanded its suite of documentation with the publication of fronted agreements for leveraged acquisition finance transactions, a mezzanine facility drafting guide for leveraged finance transactions, template Italian law private placement documentation and a confidentiality agreement governed by South African law.

In 2018, we expanded our suite of documentation across several sectors and product areas, with the publication of various new documents: an intercreditor agreement for leveraged acquisition finance transactions anticipating a combination of senior term debt and a super senior revolving facility; a mezzanine facility drafting guide for real estate finance transactions; German- and English-language Schuldscheindarlehen templates; a facility agreement for use in buyer credit transactions supported by an export credit agency; a facility agreement incorporating a letter of credit facility for use in developing market jurisdictions; a revised "Replacement of Screen Rate Clause" to provide further flexibility in light of uncertainty over the discontinuance of LIBOR; and a new template secondary trade recap, the key purpose of which is to minimise negotiation of the trade confirmation in the secondary settlement process.

Looking ahead to 2019, the LMA's documentation projects once again reflect the breadth of the LMA's work across EMEA. The LMA is working to produce a security agreement for use across common law jurisdictions in Africa, a facility agreement for a post-production commodity borrowing base facility, various real estate finance ancillary documents and a guide to intercreditor agreements. In addition, the LMA intends to publish a set of sustainability linked loan principles, which will provide a high-level framework, setting out market standards and guidelines, with a view to creating greater consistency in relation to the sustainability linked loan product.

Brexit: while the UK referendum vote in June 2016 to leave the EU will have a major impact on the future financial landscape in the UK and Europe, in the vast majority of cases it does not bring about any immediate legal or contractual change. It is still too early to speculate on the implications for the syndicated loan market of the UK's withdrawal from the EU and much will depend on the form of negotiated exit. Needless to say, the LMA is closely following developments and will, in due course, address any documentary changes. In the meantime, however, a number of notes have been published addressing a number of considerations for syndicated lending and LMA facility documentation.

LIBOR: in July 2017, the Chief Executive of the UK Financial Conduct Authority gave a speech about the future of LIBOR, noting that market participants should not rely on LIBOR being available after 2021 (see Advocacy and Lobbying below). Clearly the adoption of a replacement benchmark rate would have wide ranging implications across the loan market and would impact the technical workings of LMA documentation. Study and discussion are ongoing and at the time of writing there is no obvious alternative to LIBOR for the syndicated loan market. Until a suitable alternative benchmark rate is identified and accepted by market participants, LMA recommended form documentation cannot be updated to reflect a new benchmark rate. However, the LMA did in 2018 publish a revised version of the existing "Replacement of Screen Rate Clause".

Review and Development

In response to member feedback, market developments, legislation and regulation, the LMA's document library is constantly reviewed and updated. Primary and secondary recommended forms have undergone several revisions and seen some significant amendments, a notable example being the combination of secondary par and distressed trading documents in 2010, updated once again in 2012. Continuing the theme, terms & conditions for secondary loan trading were subject to a full "Plain English" review in 2013 with the goal of making these more navigable, particularly for those whose native language is not English. Further revisions to secondary terms & conditions were subsequently agreed including, *inter alia*, clarification of treatment of notary fees and to reflect, amongst other things, recent changes to ERISA.

In late 2014, revised primary facility agreements were published, *inter alia*, to facilitate the use of non-LIBOR interest rate benchmarks following the discontinuance of certain tenors and currencies. In 2015, anti-trust amendments were incorporated into mandate letters and the confidentiality and front running letter for primary syndication. French, German and South African law investment grade templates have all been updated and general updates were published to the suite of documents to reflect legal and market issues, such as changes in the accounting treatment of leases (IFRS 16) and the new ICE LIBOR submission methodology. Leveraged documentation was also recently revised to include, among other things, an optional incremental facility.

In 2018, we updated our suite of developing markets facility agreements, our confidentiality and front running letter for primary syndication and our secondary documentation, as part of the ongoing review of our entire documentation suite.

Market Practice and Guidelines

LMA guidelines are widely regarded as defining good market practice and typically address those aspects of loan market business not specifically documented between parties. Guidelines produced include those covering the use of confidential information, a guide to waivers and amendments and transparency guidelines.

The first in a series of market guides, *Regulation and the Loan Market*, published late 2012, met with considerable interest from the membership. This publication was subsequently updated to reflect ongoing regulatory developments and is currently undergoing another update. Other guides in the series have included *Insolvency in the Loan Market*, *Using English Law in Developing Markets* and a *Glossary of Terms for Transfers of Interests in Loans*. Current guides available on the LMA website include a *Guide to Syndicated Loans and Leveraged Finance Transactions*, a *Guide to Agency Protections*, a *Guide to Secondary Market Transactions* and a *Guide to Secondary Market Liquidity*. A Comparison of Private Placement Debt Products was published in July 2016. In 2017, a *Guide to Dealing with Requests for Amendments* was released, as well as an *Introduction to Position Reconciliation* and a paper on *Why We Need Identifiers*. Most recently in early 2018, after significant input from members of the Loan Operations Committee, the LMA published *An Agent's Guide to Handling Ancillary Facilities*.

Most recent publications include: a recommended timeline for settlement of primary syndication incorporating delayed settlement compensation, as part of our efforts to reduce settlement times for primary syndications; a set of comprehensive green loan principles (following closely the core components of ICMA's Green Bond Principles); and a supplementary note to inform members of market discussions/concerns surrounding the documentary implications of Brexit. A series of desktop reference guides for operations practitioners was also published during 2018, covering areas such as agent freezes, prepayments and breaks. A guide was also produced jointly with the ACT on the future of LIBOR, which provides an overview of developments and key issues with the transition away from LIBOR. A third edition of this guide is due to be published shortly.

Advocacy and Lobbying

The LMA seeks to maintain a dialogue with regulators and government bodies wherever new or revised regulatory proposals may impact the loan market, whilst also proactively promoting the market as a core funding source in the corporate economy. Since the financial crisis of 2007, this area of the Association's work has grown in importance as the number of regulatory proposals has dramatically increased. Policy decisions underlying the new proposals are largely to be supported, the overarching aim being a more robust financial system better able to shoulder economic shock and withstand periods of stress. The LMA's lobbying focus has been on the potentially negative implications of these proposals for the loan market, both intentional and unintended, and the effects on its members. Responses to regulatory bodies across the globe are too numerous to list.

Notable dialogue over recent years includes submissions *re* the impact of the EU Capital Requirements Directive ("CRD IV") on bank financing, to the OECD consultation re Base Erosion and Profit Shifting ("BEPS"), the EC consultation on European Capital Markets Union and submissions to the EC, PRA and FCA re the Article 55 bail-in directive. Also to highlight are responses to the Financial Stability Board, EC and EBA consultations on strengthening oversight and regulation of both banking and shadow banking, a response to the HMRC consultation *re* tax deductibility of loan interest payments and lobbying the EU on its framework for simple, transparent and standardised securitisations. The LMA had previously successfully lobbied for lower risk retention requirements for new CLOs in the post-crisis era.

On the subject of the potential replacement of LIBOR from 2021, the LMA is on a number of Sterling, Euro and Swiss franc working groups and is in active dialogue with the Bank of England and the FCA to ensure that the interests of the loan market are represented. The LMA has also been responding to relevant consultations, such as the Working Group on Sterling Risk-Free Reference Rates' consultation paper on Term SONIA Reference Rates ("TSRRs"), the public consultation on determining an ESTER-based term structure methodology as a fallback in EURIBOR-linked contracts and the US ARRC consultation on fallback contract language for syndicated business loans. Given the importance of a consistent approach being adopted across the financial markets, the LMA has also brought together relevant trade associations in the financial markets to share knowledge and market developments and discuss a coordinated way forward. We are working in particular with the other loan trade associations (namely the LSTA and APLMA), as well as ICMA, ISDA, AFME and others. The ACT is also involved in this group to ensure borrower input. The LMA continues to keep the market informed of developments and, in September 2018, the LMA and

ACT released a second edition of the joint guide entitled *The future of LIBOR: what you need to know*.

Basel III/IV and the related EU Capital Requirements Directives and Regulations will have an ongoing impact on the lending environment, whilst securitisation regulation, ECB leveraged lending guidelines, proposed regulation of NPLs, Brexit and the European Commission study of competition in the loan market will offer further challenges. We will also continue to track changes in accounting principles that could have a material impact on the product, and other issues, such as sanctions and tax regulations.

In response to requests by members to address the issues associated with KYC, we recently undertook extensive work in the context of AML. This resulted in publication of new JMLSG guidelines, appointment to the JMLSG board, and increased dialogue with AML supervisors. We hope that our participation in this area will help improve existing market practices whilst ensuring that the product remains low risk from a money laundering perspective.

As the loan product and the market evolve, we will be required to monitor more recent initiatives such as green lending and financial technology ("FinTech"), especially as they become the subject of increased scrutiny by regulators and market stakeholders alike, to ensure that the syndicated loan as a product is able to adapt to meet the needs of an increasingly sophisticated market.

Education and Events

As a core objective, the LMA seeks to educate members and others regarding documentation and legislative, regulatory, legal, accounting, tax and operational issues affecting the syndicated loan market in EMEA. As the industry's official trade body, the LMA is the ideal education and training resource for what has become an increasingly technical market. Relationships with the key players in the market afford the LMA access to some of the leading experts in their field and as such the credentials of contributors can be guaranteed.

Evening seminars and documentation training days are regular calendar events in the UK. Also, to reflect the multi-jurisdictional membership base, seminars, training days and conferences are held in many other financial centres, including Frankfurt, Paris, Amsterdam, Brussels, Milan, Madrid, Vienna, Zurich, Stockholm, Istanbul, Moscow, Dubai, Nairobi, Lagos, Johannesburg and New York.

In September 2018, over 1,000 delegates attended the LMA's 11th annual Syndicated Loans Conference in London (with a further 430 watching by live relay), the largest loan market event in EMEA. Additionally, the LMA now also runs a joint LMA/LSTA Conference in London, an annual Developing Markets Conference in London, an annual Real Estate Conference in London and Frankfurt/Munich, and conferences in East and South Africa. In total, over 17,000 delegates have attended LMA events in the last three years.

In 2005, the inaugural LMA Certificate Course was held in London. Consistently oversubscribed, the course is now entering its 13th year and will be run three times in 2019. Held over five days, the course covers the syndication process through to secondary trading, including agency, portfolio management, pricing and mathematical conventions, terms sheets and an introduction to documentation.

The Syndicated Loans Course for Lawyers is a two-day programme, designed specifically for those working in the legal profession, providing detailed tuition on all aspects of the primary and secondary loan markets.

A Loan Documentation Certificate Course was launched in 2016, affording professionals a more in-depth understanding of LMA primary documentation. This has been run in London and Johannesburg and in 2019 will run in Frankfurt and Nairobi. A Real Estate Finance Certificate Course was also launched, aimed at junior professionals in that sector.

In 2011, the LMA published *The Loan Book*, a comprehensive study of the loan market through the financial crisis, with contributions from 43 individual market practitioners. Over 10,000 copies of *The Loan Book* have been distributed to date since publication. In 2013, the Association published *Developing Loan Markets*, a book dedicated to the analysis of various regional developing markets, both from an economic and loan product perspective. Adding to the series, the *Real Estate Loan Book* was published in May 2015. In recognition of the 20th anniversary of the LMA, the latest book – *20 Years in the Loan Market* – was published in November 2016. Again the result of contributions from leading practitioners from across the market, the publication looks back at the last two decades of the syndicated loan market, analysing its evolution over that period.

In August 2015, the LMA launched a webinar programme, offering members across the globe access to training on demand, with concise and comprehensive tutorials across a range of topics presented by senior industry professionals. The programme expanded in terms of coverage in 2016 to include sessions in French, German and Spanish. At the time of writing there were 35 webinars available to view. A series of spotlight interviews were also launched, providing short updates on key regulatory and topical issues impacting the loan market.

Working in close collaboration with the LMA Operations Committee (see below), in October 2016 the LMA launched its first e-learning programme, Understanding the Loan Market. Aimed at practitioners across the market, be it from a legal, financial or operations background, the course seeks to create a knowledge benchmark for the asset class. The course consists of 10 modules in total and is free of charge for LMA members. To date, over 5,000 delegates from 60 jurisdictions have registered on the dedicated e-learning portal. A standalone module covering the particular characteristics of Schuldscheindarlehen was added in 2018.

In 2019, we plan to hold over 90 events throughout EMEA, as well as expand our e-learning offering and release further webinars and spotlight interviews. During 2019, we will also be running events in more cities than ever before, namely, Amsterdam, Berlin, Birmingham, Brussels, Dubai, Dublin, Edinburgh, Frankfurt, Istanbul, Johannesburg, Kampala, Kigali, Lagos, London, Madrid, Manchester, Milan, Moscow, Munich, Nairobi, Paris, Prague, Stockholm, Tel Aviv, Vienna, Warsaw and Zurich. We will also hold the following conferences throughout 2019: Real Estate Finance (London and Frankfurt); Developing Markets (London); Loan Operations (London); East Africa (Nairobi); Sub-Saharan Africa (Johannesburg); Middle East (Dubai); FinTech (London); and our annual Syndicated Loans Conference (London), now in its 12th year and attended by over 1,000 delegates.

Loan Operations

Operational issues have long been raised by LMA members as an area of concern, particularly around administrative agency and the potential for significant settlement delays in the secondary market. Syndicate size alone can lead to process overload when waivers and amendments are combined with transfer requests. The LMA has a dedicated Loan Operations Committee focused on identifying roadblocks, communicating issues and promoting best practice solutions. Several administrative "quick-wins" have been implemented across top agency houses since 2014 as a direct result of the Committee's work. Since Q4 2014, the LMA has consolidated and published secondary trade settlement statistics from major

European trading desks in order to help benchmark efficiency gains going forward. An LMA-driven escalation matrix, where participants agree to share contact details in case an issue requires escalating internally, has proved to be of significant benefit to reduce query bottlenecks.

In June 2018, the LMA held its 4th Loan Operations Conference to showcase the work of the committee and highlight issues faced by operations teams across the market.

FinTech is high on the agenda at most major financial institutions and the LMA is engaged with banks, lawyers and vendors alike to understand the potential implications of innovative technology such as blockchain, in particular as it may impact operational processes in the medium term. FinTech discussions are now regular features at LMA seminars and a dedicated conference is planned for 2019.

During the course of 2018, we have actively engaged in various regulatory initiatives, most notably assisting in drafting the revisions to Chapter 17 of the JMLSG Guidance. In addition, we have produced a number of documents, including a global administrative details form and agency details form, both of which seek to provide a standard format for communicating key administrative details; an agent's guide to handling ancillary facilities, which seeks to provide an introduction to ancillary facilities and their treatment in LMA facility documentation, together with guidance on common operational scenarios; and the new desktop series as previously mentioned.

We continue to work tirelessly to break down communication barriers in the syndicated loan market as a whole, through the promotion of our escalation matrix and via our education forums, including our flagship operations conference which attracts over 300 operations professionals. Maintaining the spotlight on secondary settlement and operations in general is a core strategic aim for the LMA into 2019 and beyond.

Market Overview

A detailed study of the development of the syndicated loan market in EMEA, particularly post the financial crisis of 2007–2009, is beyond the scope of this chapter. *The Loan Book*, as mentioned above, gives a practitioner's overview and detailed reference guide, as does the LMA's latest publication *20 Years in the Loan Market*. It goes without saying, however, that the crisis sparked by the US sub-prime mortgage market had a significant impact. Fuelled by an abundance of liquidity, particularly from institutional investors in the leveraged market, primary volumes in EMEA soared in the years building up to the crisis. The liquidity crunch saw primary issuance fall dramatically by 2009 to barely one-third of the record €1,600bn seen in 2007. Volumes recovered some ground through to 2011 but dipped again in 2012 against the backdrop of the Eurozone sovereign debt crisis and the US "fiscal cliff". In contrast, 2013 saw markets rebound and loan issuance increase substantially. Policy intervention and specifically the Outright Monetary Transactions programme announced by the ECB in the 2nd half of 2012 was a significant driver of confidence. In 2015, EMEA total loan market volumes topped €1,200bn for the first time since the crisis. EMEA volumes have levelled off slightly since then and stood at just over €1,000bn in 2018.

Demand for the leveraged loan product in particular has spread across a broader investor base than seen prior to 2007. Credit funds and managed accounts have a larger foothold than previously, though CLOs are now again a major player. A significant driver of demand within leveraged finance pre-crisis, the CLO returned to European markets in 2013 with new vehicle issuance volume of €7.4bn, compared with virtually zero since 2008. European CLO issuance reached a post-crisis high of €27.4bn in 2018.

Institutional investors have also become more visible in other loan asset classes, such as real estate and infrastructure finance. A multitude of funds have also been set up to lend directly to small and medium companies, particularly in the UK. Retrenchment by banks immediately post crisis opened the door to alternative sources of finance across the loan market and many larger institutions are now established participants. Many more managers have raised dedicated loan funds over the last few years and competition for assets is becoming intense, especially as several banks have actively looked to expand activity in the sector.

The Way Forward

Results from a survey of LMA members at the end of 2018 suggest that market participants are cautiously optimistic about prospects into 2019, although the results also recognise some of the challenges faced in the global environment. Some 36.5% of respondents expect loan market volumes across EMEA to grow at least 10%, versus only 18.8% predicting lower volumes. Global economic and/or geopolitical risks (including Brexit) were cited as the biggest potential influence on the market in 2019 with 60.8% of respondents, with competitive pressure second at 17.8%. Respondents saw refinancing activity as the main volume driver at 30.2% of the vote, with restructurings at 20.2% and new money requirements in corporate M&A at 16.8%. Asked how much financial regulatory change has impacted their business over the last five years, over 60% have seen a significant or material impact.

Indeed, regulatory issues remain high on the agenda and the LMA's focus on lobbying and advocacy will continue unabated. Other trends will also determine the focus of the LMA's work into 2019 and beyond. The institutional investor base has continued to grow and non-bank finance has increased in importance across loan asset classes, be it in parallel with banks in syndicated lending, in a bespoke bank/fund partnership, via unitranche or other forms of direct lending. More borrowers from developing markets will require funding from beyond domestic boundaries; the LMA will continue to expand its work in these markets to promote the acceptance of regional standards. We expect the focus on operational efficiency to continue to grow and the LMA is fully engaged with partners and practitioners across the market to identify issues, find solutions and broker change. FinTech will undoubtedly evolve to reshape the financial services industry and it will be increasingly important to trade ideas and knowledge in this area.

The LMA's principal objective some 20 years ago was to promote greater liquidity and efficiency in the loan market, an objective which remains as, if not more, relevant today.

Acknowledgment

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Nigel is Managing Director at the LMA. He has over 20 years' experience in loan markets, from origination and structuring through to sales, trading and workout. Prior to joining the LMA in 2012, Nigel was at GE Capital in London for seven years, where he was head of secondary sales & trading for the European leveraged finance business. In 10 years at Commerzbank, Nigel ran the London-based distressed portfolio and was a founding member of the bank's London structured finance & loan syndications team. He served as an LMA Board Member for several years during this time. Nigel began his City career via a graduate programme at Deutsche Bank following training at Coopers & Lybrand Deloitte. Nigel has a BA (Hons) from the University of Durham.

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Hannah joined the LMA's legal team in November 2018 and assists with the Association's documentation projects, education and training events and regulatory and lobbying matters.

Prior to joining the LMA, Hannah was a banking and finance solicitor at Osborne Clarke LLP where she acted for numerous domestic and international corporate banks and UK and international borrowers on a variety of syndicated finance transactions, with a particular focus on real estate finance.

Loan
Market
Association
the authoritative voice
of the EMEA market

The Loan Market Association (LMA) has as its key objective improving liquidity, efficiency and transparency in the primary and secondary syndicated loan markets in Europe, the Middle East and Africa (EMEA). By establishing sound, widely accepted market practice, the LMA seeks to promote the syndicated loan as one of the key debt products available to borrowers across the region.

As the authoritative voice of the syndicated loan market in EMEA, the LMA works with lenders, law firms, borrowers and regulators to educate the market about the benefits of the syndicated loan product, and to remove barriers to entry for new participants.

Since the establishment of the LMA in 1996, the Association's membership has grown steadily and now stands at over 700 organisations covering 60 nationalities, comprising commercial and investment banks, institutional investors, law firms, service providers and rating agencies.

Chapter 3

Asia Pacific Loan Market Association – An Overview

Asia Pacific Loan Market Association (APLMA)

Andrew Ferguson

About the APLMA

The APLMA is a professional (not-for-profit) trade association which represents the interests of institutions active in the syndicated loan markets around the Asia-Pacific region. Its primary objective is to promote growth and liquidity in the syndicated loan markets (both primary and secondary) – which it endeavours to do by advocating best market standards and practices; maintaining a suite of highly professional standard documents; engaging with regulators on key matters affecting the markets; organising conferences and knowledge-sharing events in member countries; and providing a professional networking platform for members across the region.

Standard Documentation

One of APLMA's key areas of activity has been to create, promote and regularly update standard documents for syndicated loan transactions in the APAC markets, and APLMA now has an extensive suite of loan documents governed by English, Hong Kong, Australian, Singaporean and Taiwanese law. These documents constitute the market standard in most of the jurisdictions around the APAC region and considerable effort goes into the ongoing review and update process to ensure that APLMA's documents reflect best market practice and ongoing regulatory changes.

The APLMA has also created (and continues to develop) other related templates to assist market participants in their day-to-day loan market activities. These include term sheets, mandate letters, confidentiality letters, as well as templates for secondary market transactions (including sub-participations) under both English and Hong Kong law. Best practice notes also include guidance on (*inter alia*) agency functions, fee sharing, competition law, FATCA, KYC and electronic communications, and many of APLMA's documents provide 'wording footnotes' to assist with client negotiations. Increasingly, and given the burgeoning influence of Chinese institutions in the APAC region, key documents have been translated into Chinese.

All of these standard loan agreements and other related documents are available free of charge to members of the Association on the APLMA website.

APAC Regulatory Guide

In June 2017, the APLMA launched its first 'Asia Pacific Regulatory Guide', which summarises some of the key regulatory changes which have occurred over the past few years (including sections on FATCA, Brexit, Competition Law, Basel III, sanctions, etc.). This guide serves as a useful reference and can be found on the APLMA website.

Conferences, Seminars and Knowledge-Sharing Events

In 2018, the APLMA hosted more than 100 conferences, seminars, training courses and networking events for the purposes of enhancing industry education, encouraging debate, and providing a vibrant professional network for members across the APAC region. These included the two flagship events, the Global Summit (held in Hong Kong in January 2018 and attended by more than 350 delegates) and the Annual Conference held in Macau in June 2018 (250+ delegates). Highly successful conferences were also held in Bangkok, Beijing, Ho Chi Minh City, Jakarta, Melbourne, Mumbai, Seoul, Singapore, Taipei and Yangon.

Of particular note were the two Leveraged Finance conferences held in Hong Kong and Singapore in September and October 2018 respectively. These were both standout and over-subscribed events which demonstrated the critical importance of knowledge sharing, as well as the growth/importance of the lev-fin markets in the APAC region.

The various teach-in events around the regions were also well attended. Worthy of mention was the Taipei wind farm finance workshop, the documentation workshops in Hong Kong and Singapore, and the various specific sector teach-ins in Singapore (addressing, among other things, pre-export finance, commodity finance and the evolution of LIBOR).

APLMA in China

In line with the Association's drive to reach out to multiple important Chinese cities outside of the two principal cities of Beijing and Shanghai, the APLMA held its inaugural Loan Market Conference in Hangzhou in April 2018. Hangzhou is a major industrial city and financial centre in its own right and home to some of the largest companies in China.

A further (and highly successful) regional conference took place in Shenzhen in January 2019, and a conference in Tianjing is (at the time of writing) also being planned for later in 2019.

Sustainable Finance

APLMA has taken the lead in projecting the vision and objectives of the Paris Agreement to its members in the APAC region. The Association frequently provides a platform at its conferences for education and debate on this important topic and is also part of an important global group which continues to discuss the evolution of green and sustainable finance.

Of particular note is that, in March 2018, APLMA (jointly with LMA) launched the Green Loan Principles ("GLPs"). The GLPs aim to create a high-level framework of market standards and guidelines which facilitate a consistent methodology across the wholesale green loan market. The GLPs build on and refer to ICMA's Green Bond Principles, which helps to promote consistency across financial markets, and provide a practical framework for loan market participants to engage in and develop sustainable finance in the future.

The GLPs are based on the same four pillars set out in the GBP, namely:

(i) use of proceeds;

(ii) process for project evaluation and selection;

(iii) management of proceeds; and

(iv) reporting.

In November 2018 (and jointly with LMA and LSTA), APLMA announced a second iteration of the GLPs which address and provide more clarity on revolving facilities and KPI-linked sustainability finance, a subject that will no doubt continue to evolve and grow in importance in future years.

LIBOR Transition

The evolution of risk-free benchmark rates and the expected demise of LIBOR cannot have escaped anyone's attention over the last 12 months. The charge towards risk-free benchmarks was originally (and understandably) led by the derivatives markets, which focused entirely on historical overnight rates in liquid markets; and it is only in the last 6–12 months that the cash markets have woken up to the fact that impending changes to benchmark rates and the disappearance of LIBOR will have dramatic side effects in the cash markets (and notably in the loan markets) where forward-looking term rates have been the norm for decades.

As a result, the APLMA is an active member of the Global LIBOR Trade Association Group (principally led by LMA) and was involved in 2018 with other global trade organisations in finalising a list of issues presented in a letter to the Financial Stability Board. APLMA has also engaged with a number of other parties (including regulators and central banks) on this issue and has hosted LIBOR reform briefing sessions in both Hong Kong and Singapore and raised the subject at every APLMA conference held in the APAC region over the last 12 months.

APLMA has also been keeping a very close eye on the consultations held by the Bank of England and the Alternative Reference Rate Committee in the US on the development of forward-looking term rates and the subject of documentation fall-back language, and recently joined the inaugural meeting of the Working Group on Alternative Reference Rates set up by the Hong Kong Monetary Authority and the Treasury Markets Association in Hong Kong in relation to a possible successor for HIBOR.

At the time of writing, it is not clear what will ultimately take the place of LIBOR and whether LIBOR will actually disappear at the end of (or even before) 2021. What is clear is there is a massive legacy of existing loan agreements that will need to be individually amended and the problem is growing with every day that passes. Quite clearly the loan markets (including borrowers, lenders, agent banks, and other financial intermediaries) are fundamentally unprepared for the demise of LIBOR and much work remains to be done.

Looking Ahead

With the regulatory landscape constantly changing, the APLMA will continue to monitor fiscal and regulatory developments in the APAC region and publish market guidance notes to assist members in assessing the extent of the potential impact on the loan markets. It will also be engaging actively with regulators in the region and, as part of its commitment to enhance industry skills and education and provide members with a vibrant professional network, it will continue to host regular seminars and conferences in major cities and financial centres across Asia Pacific.

Specific projects in the planning stage or already in motion include:

- a project to develop a standard bilateral loan agreement in India (governed by Indian law), to be followed by a standard syndicated INR loan agreement;
- enhancing the role of the APAC LIBOR working group, focusing on IBOR evolution and fall-back language in APLMA documents;
- attracting more non-bank investors into the loan asset class and improving secondary market liquidity;
- maintaining momentum on the further development of Green Finance; and
- developing and improving APLMA's training and knowledge sharing offering and make it more accessible in less developed frontier countries in APAC.

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Chief Executive Officer

A veteran of the banking industry (a career spanning 39 years with Lloyds, Bank of America, BNP Paribas, HSBC and ANZ), Andrew established a successful consulting business in Hong Kong in 2012, as a result of which he delivered the APLMA Certificate Course in Hong Kong, Singapore and Sydney in 2016 and 2017 and then undertook an intensive research project for the APLMA in 2017. He was appointed as Advisor to the Board of APLMA in February 2018 and appointed as Chief Executive Officer in November 2018.

Andrew was educated at Southampton University in England, is an Associate of the Chartered Institute of Banking and a Fellow of the Hong Kong Institute of Directors, and twice served as the Chairman of the Capital Markets Association in Hong Kong.

APLMA Anniversary 20 YEARS SERVING THE LOAN MARKET

APLMA was founded in August 1998 by 15 major international banks. As at the end of 2018 it had 323 members made up of banks, non-bank financial institutions, law firms, insurance companies, rating agencies, multilateral agencies, financial information service providers and other financial intermediaries. It is headquartered in Hong Kong with a full legal branch in Australia and a management committee in Singapore, as well as offshore committees in China, India, Malaysia, New Zealand and Taiwan.

APLMA cooperates closely with its sister associations in Europe and North America (the LMA and LSTA) and with other trade organisations around the globe. Several regulators in APAC (notably HKMA and MAS) are Honorary Members.

Chapter 4

An Introduction to Legal Risk and Structuring Cross-Border Lending Transactions


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1 Introduction: The Rise of Cross-Border Lending

Increase in Cross-Border Lending. For lenders and lawyers who practise in the cross-border lending area, whether in the developed economies or the emerging markets, this is a dynamic and exciting time. Cross-border lending has increased dramatically over the last couple of decades in terms of volume of loans, number of transactions and number of market participants. According to the Bank for International Settlements, the amount of outstanding cross-border loans held by banks worldwide has increased from approximately $1.7 trillion in 1995 to over $7 trillion today. There are many reasons for this increase: the globalisation of business and development of information technology; the rise of emerging economies that have a thirst for capital; and the development of global lending markets, especially in the US, which has led to a dramatic rise in the number of market participants searching for the right mix of yield and risk in the loan markets, a search that often leads to cross-border lending opportunities.

Challenges of Cross-Border Lending. In addition to understanding the creditworthiness of a potential borrower, the overlay of exposure of a lender to a foreign jurisdiction entails analysis of a myriad of additional factors, the weighting of which will vary from country to country. This mix of political, economic and legal risks, bundled together, is referred to collectively as *country risk*. Understanding country risk is imperative for lenders and investors to be able to compare debt instruments of similarly-situated companies located in different countries.

Examination of Legal Risk. This first overview chapter of the *Guide* provides some observations on an element of country risk that is closest to the hearts of lawyers: *legal risk*. Together with tax considerations, understanding legal risk is important for structuring cross-border loan transactions. But what exactly is legal risk? Can legal risk be measured? What tools do lenders traditionally use to mitigate legal risk? Do these tools work? Finally, we complete this chapter with some observations on how conventional notions of legal risk are being challenged.

2 Legal Risk in the Cross-Border Lending Context

What is Legal Risk? Young lending lawyers are taught that when a loan transaction closes, "the borrower walks away with a pile of the lender's money and the lender walks away with a pile of paper *and the legal risk*". If the borrower refuses to pay the money back, then the lender must rely on the *pile of paper and the legal process*, in order for the money to be returned. This notion helps drive the point home that legal risk is primarily something that keeps lenders (rather than borrowers) awake at night. While there is no settled description of legal risk, it can be thought of as having a number of components, starting with *documentation risk*, which is mitigated by having competent counsel ensure that legal documentation correctly reflects the business arrangement and is in the proper form. In a cross-border lending context it is useful to think of legal risk as having two additional related and sometimes overlapping components: (1) *enforcement risk*; and (2) *the risk of law reform*.

Enforcement Risk. Lenders prefer to enter a lending transaction knowing that a number of "enforcement components" are in place to allow for enforcement of loan documentation (that *pile of paper*) and to resolve disputes and insolvency in a predictable way. These components include a well-developed body of commercial law, an independent judiciary and an expedient legal process. In a cross-border lending context, especially if a borrower's primary assets are located in a foreign jurisdiction, there is typically some reliance by a lender on the laws, legal institutions and legal process of that foreign jurisdiction.

For example, a US lender seeking to enforce a loan agreement against a foreign borrower could do so in one of two ways. Assuming the borrower has submitted to the jurisdiction of New York courts, the lender could file suit in New York against the borrower, obtain a judgment from a New York court, and then seek to have that judgment enforced against the assets of the borrower in the borrower's home country. In the alternative, the lender could seek to enforce the loan agreement directly in the courts of the foreign jurisdiction. In either case, there is reliance on the laws, institutions and legal process in the borrower's home jurisdiction.

If the foreign jurisdiction's local law is not consistent with international norms, or its legal institutions are weak, corrupt or subject to undue political influence, then *enforcement risk* may be considered high. It should be noted that enforcement risk may be high even in a jurisdiction that has modernised its commercial laws if legal institutions have not also matured (the latter taking more time to achieve).

Law Reform Risk. Lenders also want to know that the laws they are exposed to in connection with a loan to a borrower will not arbitrarily change to the lender's detriment. This aspect of legal risk is closely associated with political risk. Law reform risk detrimental to lenders is at its highest when a country is undergoing some sort of systemic crisis. For example, in 2002 during Argentina's financial crises, the government of Argentina passed a law that converted all obligations of Argentine banks in US dollars to Argentine pesos. Given that pesos were only exchangeable at a fixed rate that did not accurately reflect a true market rate, this change in law had the effect of immediately reducing the value of the lenders' loans.

Why Legal Risk Matters. If enforcement risk is high, this weakens a lender's negotiating position in the case of a workout of a loan (as compared to a similarly situated borrower in a country where enforcement risk is low). If law reform risk is high, lenders risk a multitude of unsettling possibilities, some examples of which are described below. In each case, this increased risk should be reflected in increased pricing. In cases where the risk and/or pricing of a loan is considered too high, then a loan transaction may be structured in order to attempt to mitigate the legal risk and/or reduce pricing. Lenders have a number of tools at their disposal in order to mitigate legal risk. In this way, loan transactions that might otherwise not get done, do get done.

3 Can Legal Risk be Measured?

Before examining ways to mitigate legal risk, it is interesting to examine the extent to which legal risk can be measured. Measuring legal risk is not an exact science, though it nevertheless can be a useful exercise to consider yardsticks that might provide a sense of one country's legal risk relative to another's. A threshold challenge is that while there are many tools available to measure *country risk*, *legal risk* is only one component of country risk. Nevertheless, there are some tools that may be helpful. In terms of measuring legal risk, the conventional wisdom is that developed economies have stronger legal institutions and less legal risk when compared to emerging market jurisdictions.

The Usefulness and Limitations of Sovereign Ratings. Sovereign ratings measure the risk of default on a sovereign's debt. These ratings are useful to get a "systemic" view of how a country is doing economically. A country that has a high sovereign debt rating is likely to be financially stable. A country that is financially stable is less likely to undergo systemic stress, at least in the short term, and therefore less likely to undergo *law reform* adverse to lenders (remember the link between systemic stress and law reform noted above).

But does it follow that there is a correlation between a sovereign's rating and *enforcement risk* against private borrowers in the sovereign's jurisdiction? A sovereign's risk of default on its debt instruments may be low because the country has extensive state-owned oil production that fills the country's coffers. This would not necessarily indicate that a country's legal institutions would fairly and efficiently enforce a pile of loan documents against a borrower in that jurisdiction – the legal institutions in such a country might be corrupt and/or inefficient. While a quick review of sovereign ratings suggests that there is at least some correlation between ratings and enforcement risk, there are also some outliers (for example, at the time of writing, Bermuda and China have similar long-term sovereign ratings from Standard & Poor's, though international lenders probably consider enforcement risk to be more significant in China than in Bermuda).

Sovereign Rate Spreads and Sovereign Credit Default Swap Prices. One of the simplest and most widely used methods to measure *country risk* is to examine the yields on bonds issued by the country in question compared to a "risk free" bond yield (still usually considered the US). A comparison of sovereign debt credit default swap prices provides a similar measure. As with sovereign ratings, this tool is useful to obtain a measure of potential systemic stress and *law reform risk* but seems less useful in terms of measuring *enforcement risk* of a borrower in that jurisdiction for the same reasons provided above.

Recovery after Default Analysis. A type of analysis performed by ratings agencies that might be considered useful for measuring legal risk from country to country is corporate default and recovery analysis. A reasonable hypothesis might be that the average recovery for creditors after a borrower default would be higher countries with low legal risk: stronger institutions means higher recoveries for creditors. But a review of the data suggests there is little or no such correlation. Why is this? There are a few possible explanations: recovery rates depend on a variety of factors other than legal risk, including the severity of default and the makeup of the individual borrowers subject to the analysis. It also is probable that lenders in a country with strong legal institutions (and low risk) may be more willing to make "riskier" loans (based on a portfolio theory of investment) given they have confidence in the jurisdiction's strong legal institutions to resolve defaults and insolvency in a predictable manner.

World Bank "Doing Business" Rankings. The World Bank publishes an interesting study each year titled the *Ease of Doing Business Rankings*. These rankings rate all economies in the world from 1 to 190 on the "ease of doing business" in that country, with 1st being the best score and 190th the worst (see http://doingbusiness.org/rankings). Each country is rated across 11 categories, including an "enforcing contracts", "resolving insolvency" and "protecting investors" category. The rankings provide a helpful tool for comparing one country to one another. While there is not space to detail the methodologies of the rankings in this chapter, the methodologies can produce some unexpected results. For instance, in the 2018 rankings, each of China, Belarus and the Russian Federation have a better "enforcing contracts" score than the United Kingdom. Nevertheless, these rankings can be a useful benchmark and are worth mentioning.

Subjectivity. Ultimately, in addition to the data described above, a lender's perception of the legal risk of lending into a particular country will be driven by a number of geographic, historical, political, cultural and commercial factors peculiar to the lender and the country in question. For example, as a general matter, French lenders seem more comfortable than US lenders when lending to borrowers in Africa, while US lenders seem generally more comfortable than French lenders lending to borrowers in Latin America. (UK lenders seem comfortable lending anywhere!) Lenders will measure legal risk differently based on their institution's experience and tools at hand to work out a loan should it go bad.

4 Tools Used to Mitigate Legal Risk

The fact that a borrower is located in a jurisdiction with a high level of legal risk does not mean that a loan transaction cannot be closed. Lenders have been closing deals with borrowers in far-off lands since the Venetians. Today, lenders use a number of tools to help mitigate legal risk, both in terms of structuring a transaction and otherwise. These concepts are used in all sorts of financings, from simple bilateral unsecured corporate loans to large, complicated syndicated project financings with a variety of financing parties. Which of these tools will be available to a lender will depend on a variety of factors, especially the relative negotiating positions of the borrower and lender for a particular type of transaction.

Governing Law. As a starting point, the choice of governing law of a loan agreement is important because it will determine whether a contract is valid and how to interpret the words of the contract should a dispute arise. The governing law of most loan agreements in international transactions has historically been either New York or English law. This is primarily because these laws are considered sophisticated, stable and predictable, which lenders like. Also, lenders generally prefer not to have a contract governed by the law of a foreign borrower's jurisdiction, since lawmakers friendly to the borrower could change the law in a way detrimental to the lender (law reform risk). As part of any cross-border transaction, lending lawyers spend time ensuring that the choice of governing law will be enforceable in the borrower's jurisdiction, often obtaining coverage of this in a legal opinion delivered at closing.

It should be noted that that while a loan agreement may be governed by New York or English law, the collateral documentation (the documentation whereby the borrower pledges assets as collateral to secure the obligations under the loan agreement) is almost always governed by the law where the assets are located – often that of the borrower's home jurisdiction. As a general matter, courts generally have the power to adjudicate issues relating to property located in their jurisdiction. Sometimes local laws require that the collateral documentation be under local law, though in any event local courts are more efficient interpreting and enforcing collateral agreements that are governed by their own law.

Recourse to Guarantors in a Risk-Free Jurisdiction. A lender to a borrower in a jurisdiction with high legal risk may require a parent, subsidiary or other affiliate of the borrower in a "risk-free" jurisdiction to guarantee the loan. In this type of situation, the lender would want to ensure that the guaranty is one of "payment" and not of "collection", since the latter requires a lender to exhaust all remedies against a borrower before obligating the guarantor to pay. In a cross-border context, this could result in a lender being stuck for years in the quagmire of costly enforcement activity in a foreign and hostile court. While almost all New York and English law guarantees are stated to be guarantees of payment, it is nevertheless always wise to confirm this is the case, and especially important if the guarantee happens to be governed by the laws of another jurisdiction.

Collateral in a Risk-Free Jurisdiction. With secured loans, if the legal risk of a borrower's home country is high, lenders will often structure an "exit strategy" that can be enforced without reliance on the legal institutions of the borrower's jurisdiction. This has been a classic tool of project finance lenders for decades and has contributed to the financing of projects in a variety of countries that have high legal risk.

a. *Offshore Share Pledge*. For example, a lender often requires a share pledge of a holding company that ultimately owns the borrower. This type of share pledge may be structured to allow for an entity organised in a risk-free jurisdiction to pledge the shares of the holding company, also organised in a risk-free jurisdiction, under a pledge document governed by the laws of a risk-free jurisdiction. Such a pledge, properly structured and vetted with local counsel, is a powerful tool for a lender, allowing a lender to enforce the pledge and either sell the borrower as a going concern to repay the loan or to force a replacement of management. In the case of such a pledge, it is important to ensure that the borrower's jurisdiction will recognise the change in ownership resulting from enforcement of such a pledge under its foreign ownership rules. When preparing such a pledge, it is important to carefully examine the enforcement procedures to ensure that the pledge can, to the maximum extent possible, be enforced without reliance on any cooperation or activity on the part of the borrower, its shareholders or directors.

b. *Offshore Collateral Account*. Another classic tool is to require a borrower to maintain an "offshore collateral account" in a risk-free jurisdiction into which the borrower's revenues are paid by its customers. In project finance structures, lenders will often enter into agreements with the borrower's primary customers requiring that revenues be paid into such an account so long as the loans are outstanding. It is important to point out that these accounts will only be as valuable as the willingness of customers to pay revenues into them. Creditworthy, offshore customers from jurisdictions where the rule of law is respected are likely to provide more valuable credit enhancement than customers affiliated with the borrower and located in the same jurisdiction.

c. *Playing Defence and Offence*. It should be noted that, in the case of a secured transaction, offshore collateral should not be viewed as a substitute for the pledge of the borrower's local assets. In such a case, a pledge of local assets is also vitally important since, at least theoretically, it preserves the value of the lender's claim against those assets against third party creditors. To use a football analogy, collateral can be thought of as having an "offensive" component and a "defensive" component: the pledge of local assets to the lender is a "defensive" move because this keeps other creditors from obtaining prior liens in these assets, while an equity pledge might be considered an "offensive" tool, allowing the lender to foreclose and sell a borrower quickly and efficiently in order to repay a loan with the proceeds.

Partnering with Multilateral Lenders or Export Credit Agencies. A multilateral development bank is an institution (like the World Bank) created by a group of countries that provides financing and advisory services for the purpose of development. An export credit agency (ECA) is usually a quasi-governmental institution that acts as an intermediary between national governments and exporters to provide export financing. Private lenders to borrowers in risky jurisdictions are often comforted when these government lenders provide loans or other financing alongside the private lenders to the same borrower, the theory being that the "governmental" nature of these institutions provides additional leverage to the lenders as a whole, given these entities are considered to be more shielded from possible capriciousness of a host country's legal and political institutions.

Reputation in the Capital Markets. A borrower or its shareholders may be concerned with their *reputations* in the capital markets in connection with a long and contentious loan restructuring exercise. This may be particularly true in the case of family-owned conglomerates in emerging markets, especially if other parts of the business need to access international financing. If access to the capital markets is not considered to be important, they may be willing to weather the storm. *See* T. DeSieno & H. Pereira, *Emerging Market Debt Restructurings: Lessons for the Future*, 230 N.Y.L.J. 39 (2003). In sovereign or quasi-sovereign situations, a government *seeking foreign investment* or striving to *maintain good relations with the international capital markets* may be less likely to be heavy-handed in a dispute with international investors.

Personal Relationships. The value of personal relationships should not be overlooked in mitigating legal risk. While personal relationships are important in both the developed and emerging markets, personal relationships play a particularly special role in those countries that do not have well-developed institutions and processes to resolve disputes. Some institutions, when working out problem loans in emerging markets, often turn the loan over to different personnel than those who originated the loan. In certain cases, it may be helpful to keep those with the key personal relationships with the borrower involved in these negotiations.

Political Risk Insurance and Credit Default Swaps. A lender may purchase "insurance" on a risky loan, in the form of political risk insurance or a credit default swap. Rather than mitigating risk, this instead shifts the risk to another party. In any event, this is a good tool to have in the lender's toolbox.

Why Good Local Counsel is Important. Finally, the value of high-quality local counsel in a cross-border loan in a high-risk jurisdiction cannot be overstated. This value comes in three forms: knowledge of local law and which legal instruments provide the most leverage to lenders in an enforcement situation; providing local intelligence on where other "leverage points" may be; and finally, by being well-connected to the local corridors of power and thereby being able to predict or "deflect" law reform in a manner helpful to clients. When choosing local counsel in a high-risk jurisdiction, spending more for the best counsel is usually worth the investment.

5 Recent Developments and Anecdotes that Both Support and Challenge the "Conventional Wisdom"

Legal Reform Risk in Developed Economies? As mentioned above, the conventional wisdom suggests that legal risk is higher in the emerging markets compared to the developed economies. But consider what happened to creditors in Ireland and Greece a few years ago. In both cases, lawmakers in these countries *changed the law* in a manner that materially and adversely impacted the rights of creditors. In Ireland, Irish lawmakers changed the bank resolution rules *to favour equity over debt.* In Greece, lawmakers changed Greek law in a way that allowed for collective active mechanics in a form that did not exist previously, effectively forcing minority shareholders to be bound by a majority vote. *See* T. DeSieno & K. Dobson, *Necessity Trumps Law: Lessons from Emerging Markets for Stressed Developed Markets?* (Int'l Ass'n of Restructuring, Insolvency and Bankruptcy Professionals, International Technical Series Issue No. 25, 2013). These and other examples make clear that even in the so-called developed economies, law reform can be a risk to creditors, especially when economies are under systemic stress.

Why New York or English Law is Still a Good Choice. In the Greek situation mentioned above, the majority of Greek bonds were issued under Greek law and some bonds were issued under English law. Bondholders holding English law governed bonds did not suffer the same consequence of the change in Greek law (since Greek lawmakers could not change English law). In this instance at least, the conventional wisdom held true.

Why Local Law May Sometimes be a Better Choice. In a recent transaction in the emerging markets, lenders were provided with a choice to have a guarantee governed by either New York law or local law. Conventional wisdom would suggest the lenders should opt for New York law. However, on the advice of a top local law firm, the lenders opted for the guarantee to be governed by local law. Why? Because after considerable weighing of risks and benefits (including the law reform risk associated with the choice of local law), it was determined the local law guarantee would provide considerably more leverage against the guarantor in the event of enforcement. It could be enforced more quickly and efficiently in local courts than a New York law guarantee (used by other creditors under other facilities) thus potentially providing an advantage to its beneficiaries. This notion of local law being better is probably more often going to be the exception rather than the rule.

Are Offshore Share Pledges Really Risk-Free? Even in cases of offshore pledge agreements that are perfectly documented as described above, lenders who have tried to enforce these pledges have sometimes run into difficulties. In jurisdictions with high legal risk, borrowers and their shareholders can prevent lenders from being able to practically realise on the value of their collateral in a number of ways: they may use the local legal system to their advantage by making baseless arguments that the change of ownership should not be legally recognised; they may transfer assets to other affiliated companies in violation of contractual obligations; or engage in countless other activities unimaginable to lenders when the loan was closed. This "hold-up" value effectively gives the borrower and its shareholders leverage not available in risk-free jurisdictions, even when the equity is "out of the money".

Does Teaming Up With Government Lenders Help or Hurt Private Lenders? As mentioned above, private lenders are often comforted when government lenders co-lend to a borrower. Is this comfort warranted? Government lenders may have motivations during a workout that extend beyond debt recovery to other goals. These goals may be maintaining good relationships with the foreign country in question, maintaining employment at home (in the case of ECAs), or instituting environmental, anti-terrorism or other policy goals. Experience with government lenders in restructuring exercises suggests that government lenders may be less willing to engage in difficult negotiations with foreign borrowers and, in the eyes of at least some private investors in certain restructuring exercises, their inclusion in a transaction has led to decreased recoveries. While government lenders can certainly be helpful to a workout process under the right circumstances, private lenders should be clear-sighted on the benefits government lenders provide.

Challenges to New York and English Law? As transaction and insolvency laws in emerging markets are modernised and become more uniform, and as legal and political institutions develop and mature, many local borrowers may push harder for local law to govern their loan agreements. At a recent syndicated lending conference focused on Latin America, local lenders in the region made clear they thought they had a competitive advantage over international lenders because they had an ability to make loans under local law, something local corporate borrowers seemed to value. The extent to which the market would soon see syndicated loans governed by local law was much discussed. While this phenomenon likely may not occur on a significant scale in the near term, it does seem that the choice of governing law may be one consideration that is increasingly in play when lenders are competing for lending mandates.

6 Final Thoughts

With the world becoming smaller, emerging markets developing and lenders searching for yield, more lenders will seek opportunities in cross-border lending. As a result, the question of legal risk will be one of increasing relevance, and local knowledge will be of increasing importance.

Lenders have a number of useful tools available to help mitigate legal risk. Ultimately, it may not be possible to reduce risk to that of a "risk free" jurisdiction. Lenders should be careful to not overestimate the comfort certain structural tools will ultimately provide. A borrower and its shareholders in a jurisdiction where the rule of law is weak typically enjoy a significant advantage over a foreign lender in a debt restructuring exercise.

Focus on structural tools should not overshadow perhaps the most important mitigant of all: the best protection against legal risk is to make a good loan to a responsible borrower with "sound commercial fundamentals". In the case of a cross-border loan to a borrower in a high-risk jurisdiction, "sound commercial fundamentals" goes beyond looking at a borrower's financial statements, projections and understanding its strategies. The most forward-thinking lenders will strive at the outset of a transaction to understand the full array of leverage points it may have against a borrower and its shareholders, including the need for future financing and/or access to the capital markets, and of the consequences of default for a borrower and its shareholders.

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Morgan Lewis

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Global Trends in the Leveraged Loan Market in 2018

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1 2018 Overview

Global syndicated lending reached an all-time high during 2018, surpassing the US$5 trillion milestone for the first time with an 8% increase in volume over approximately 10,000 closed transactions worldwide. Syndicated lending in Europe, the Middle East and Asia saw another record year in 2018, as volumes rose 17.4% to reach a three-year high of US$1.05 trillion due to stable M&A activity levels and increased refinancing activity. According to Refinitiv's LPC, the number of deals completed also increased by 13% in 2018 to 1,647, compared with 2017 data. In the Americas region (which includes the US, Canada and Latin America), despite a shaky end to the year, syndicated lending reached US$3.24 trillion from 5,060 deals in 2018, representing a 9% increase in volume compared with 2017. Loan volume in the US edged up 6% to a record US$2.5 trillion, according to Refinitiv LPC; however, this increase was due primarily to a significantly higher volume of investment grade lending. Refinancing made up most of the syndicated loan volumes, as companies tried to secure medium-term liquidity ahead of what is thought will be an uncertain 2019. Impending trade wars, Brexit, the end of the EU's quantitative easing programme, equity market volatility and political uncertainty around the world impacted liquidity and investor confidence towards the end of 2018.

- Surplus liquidity and hot competition for financings.
- Borrower-friendly markets.
- Continuing high valuations for target companies.
- Continuing new CLO issuance.
- Global political and macro-economic concerns.
- Credit funds playing an increasingly significant role.

Despite higher levels of syndicated lending overall, 2018 saw a 21% reduction in new-issue leveraged loan volumes in Europe (€95.67 billion), compared with what had been a record year in 2017 (€120.4 billion), based on data published by S&P's LCD. In the US, overall leveraged lending was also down, totalling US$1.4 trillion from 2,522 deals, which represented a 6.9% decrease from 2017 volume, largely attributable to a reduction in refinancing activity. In fact, new-issue leveraged financing in the US last year increased when compared with 2017, and the overall volume, although reduced from 2017 levels, still represented the second highest annual issuance on record. A number of jumbo LBOs (*e.g.*, Carlyle's acquisition of Akzo Nobel's specialty chemicals unit, KKR's buyout of Flora Foods Group, Macquarie's acquisition of Danish telecoms company TDC (the largest deal in Europe in 2018) and Blackstone's acquisition of Thomson Reuters Financial & Risk (now renamed Refinitiv)) were highlights of the leveraged lending landscape in 2018. According to Refinitiv, these deals contributed to the third highest total of global M&A loan volume on record at US$994 billion.

Despite investor demand for leveraged loan assets, not all deals cleared the market without adjustment in pricing and/or terms. The summer months saw a number of deals flexed on documentation terms, as volatility strengthened buyside investors' negotiating positions. However, the autumn saw a return of the sponsor-driven terms, as investors were keen to put their cash to use on big-ticket event- and relationship-driven LBOs. Signs of a change in sentiment started to show during the second half of the year, as deals were pulled amid unfavourable market conditions and a lack of investor interest during primary syndication towards the tail end of the year.

The downturn towards the end of the year was also reflected in S&P's European Leveraged Loan Index, as secondary loan prices plunged in November and December, losing 0.74% in December. This was the worst monthly performance in almost three years.

European CLO volumes rose from €20.9 billion in 2017 to €27.3 billion in 2018 with a 42.7% share of the primary market. In the US, 2018 saw the highest CLO new issue volume in history at US$128.1 billion, topping 2014's record setting year of US$123.6 billion by US$4.55 billion.

The UK remained sponsors' country of choice for European financings, followed by France and Germany by loan volume, although we expect this to look different in 2019, as Brexit uncertainties take hold. Investors continued to favour floating rate loans at the expense of high yield bonds in a rising interest rate environment. Loans made up 50.5% of the leveraged finance market, compared with bonds making up 49.5% of financings.

Like the loans market, the European high yield market saw a strong start to 2018. A few jumbo LBO transactions soaked up any remaining investor appetite in H2 2018, leaving other deals being pulled amid a tough market towards the end of the year. According to LCD, full year high yield bond issuances took €63.5 billion from 159 bonds in 2018, while 2017 saw €93.7 billion from 224 bond deals. This left 2018 with the second smallest annual volume in five years and loans as the product of choice for the leveraged finance market in H2 2018. In the US, the picture was similar. According to Refinitiv LPC, US corporate high yield bonds recorded their lowest issuance total since 2009, down 40% to US$168 billion.

2 General Comments on Convergence and Increasingly Aggressive Sponsor Terms

While covenant-lite loans were a common feature of the most aggressive US leveraged buyouts at the peak of the last credit cycle, they were rare in Europe: in 2007, only 7% of European leveraged loan issuance were covenant-lite, according to LCD. The needle has swung the other way and it is now rare for broadly syndicated leveraged loans to have maintenance covenants at all: last year, 88% of such loans in Europe were covenant-lite.

A perceived lack of supply to meet investor demand and competition between lenders has seen a trend in recent years towards increasingly attractive terms for borrowers, particularly where deals are backed by a private equity sponsor. Borrower-friendly technologies such as EBITDA add-backs, asset sales sweep step-downs and looser restricted payments and debt incurrence tests are increasingly seen, while traditional lender protections such as guarantor coverage, yield protections and transferability have been diluted or made more restrictive.

2018 saw a continued convergence between US TLB and European TLB terms and between loan and bond covenants. It can now be said that certain aspects of European deals have closed on more aggressive terms than in the US, in what some commentators describe as a "post-convergence era". Headline examples include:

- so-called "high yield bonds in disguise" have seen European leveraged loans adopting a high yield bond covenant package wholesale, through schedules sometimes interpreted in accordance with New York law, in an otherwise English law-governed facility agreement;
- the ability for borrowers to increase leverage by incurring further indebtedness has become easier, often limited only by reference to meeting a leverage test and/or a fixed charge coverage ratio, and often with a "freebie" basket and other significant baskets;
- MFN protection (which limits the amount by which the yield on an incremental facility exceeds the yield on the original loan) applies in fewer situations and switches off earlier;
- limitations on the borrower making acquisitions or disposals of assets have been reduced; according to Xtract Research, 47% of senior facilities agreements in 2018 permitted acquisitions without limit or conditions (provided that the acquired entity became part of the restricted group); asset disposals were often permitted without a cap and we have also started to see step-downs in the amount of asset sale proceeds being required to prepay loans;
- springing covenants for the benefit of RCF lenders are more difficult to trigger, often only once 35%–40% of the RCF has been drawn and sometimes only when the drawings are of a certain type or for certain purposes; and
- EBITDA add-backs and adjustments allow the borrower to take account of projected synergies and cost-savings, sometimes without a cap for financial covenant-testing purposes.

3 Investor Pushback on Syndication

In Europe, the primary syndication process during 2018 witnessed a great deal more investor pushback than in 2017 resulting in documentary and/or pricing flex around the traditional battlegrounds of margin levels, debt capacity, restricted payment capacity, unrestricted subsidiaries and EBITDA synergies and cost savings.

In the US, isolated instances of investor pushback on loose provisions occurred, especially towards the end of the year where pushback was particularly pronounced. Xtract Research noted that, in some individual cases, pushback was quite significant; *e.g.*, previously unlimited investments in non-guarantor restricted subsidiaries were capped and the amount of delevering required to access the unlimited RP basket was increased.

While the number of European deals affected by investor pushback has increased there was also a marked upturn in the number and complexity of the changes requested by investors. According to Debt Explained, some 89% of deals during 2018 were subject to documentary or pricing changes, an increase from 77% in 2017. The driving force behind such pushback represented a mixture of general concern regarding the loosening of documentary terms and a reflection of investor unease at certain credits.

The table below from Debt Explained highlights the general increase in documentary and pricing flex experienced between the second half (H2) of 2017 and the first half (H2) of 2018.

Documentary Term	H2 2017	H1 2018
Debt Cap	12%	32%
MFN Protection	10%	26%
Synergies and cost savings	6%	23%
Margin ratchet	6%	23%
Excess cash flow sweep	2%	23%
Pricing	14%	13%

4 Incremental Debt – MFN and Maturity Exceptions

MFN protection limits the amount by which the effective yield on an incremental facility exceeds the effective yield on the original loan. The yield may turn off after a stated period after closing (a "sunset"). Recently, there has been an increasing number of carve-outs to the application of the MFN.

European TLB	New York TLB
1% cap on all-in-yield or (sometimes) the margin	0.50%–0.75% cap on all-in-yield
6–12 months sunset (flex to remove or extend)	6–18 months sunset (flex to remove or extend)
Applies to *pari passu* same currency term loans	Applies to *pari passu* same currency term loans
Sometimes no MFN for incremental facilities: ■ within a threshold up to a turn of EBITDA; ■ incurred under the freebie basket; ■ which mature more than one or two years after the original debt; ■ incurred for the purpose of financing acquisitions; and ■ bridging debt	Similar (flex to modify or remove exclusions)

As a general rule, incremental facilities must not mature earlier than the initial maturity date of the original debt. There has been an increase in the circumstances in which this general rule does not apply, allowing borrowers to incur a certain amount of incremental debt that matures earlier than the original debt.

European TLB	New York TLB
Sometimes incremental facilities can mature earlier than the original debt, including incremental facilities: ■ that are not term loans; ■ incurred up to euro/sterling basket with EBITDA based grower; and ■ incurred under the freebie basket	Similar (flex to modify or remove exclusions)

5 Further Expansion of EBITDA Addbacks

Prior to 2018, add-backs and adjustments for cost savings and synergies were a firmly established practice in calculating EBITDA in the European market.

European TLB	New York TLB
Uncapped although investor pushback and now frequently see cap at 15%–25% *per annum*	Uncapped
24-month time horizon to be realisable	24-month time horizon to be realisable

Covenant Review notes that the volume of European loans clearing the market in Q4 2018 with uncapped *pro forma* adjustments rose slightly although volumes, more generally, were down on 2017. Decreased volume underlines the European market's increasing focus on uncapped *pro forma* adjustments with documentary flex items often being negotiated which include the addition of synergies and cost savings caps to typically 15%–20% of EBITDA of synergies and cost savings.

2018 also saw an extension of deals that did not require a third party reasonableness opinion as to anticipated *pro forma* synergies and cost savings and also, according to Covenant Review, an extension in the average time period permitted for the realisation of such synergies and cost savings from 17 months in 2017 to 18.8 months in 2018.

6 Transferability

Transferability has been a key topic during 2018 with assignment and transfer regimes becoming ever more restrictive for lenders.

European TLB	New York TLB
■ Borrower consent required other than: ■ to existing lenders; ■ to lenders on whitelist; and ■ during payment/bankruptcy EoD ■ Borrower consent is deemed within 10 Business Days	■ Cannot transfer to lenders on blacklist ■ Borrower consent required other than: ■ to existing lenders; ■ during a payment/bankruptcy EoD; and ■ assignments made in connection with primary syndication approved by the Borrower ■ Borrower consent is deemed within 10 Business Days

Typically, a borrower's consent right to assignments and transfers would fall away during any event of default, but increasingly consent rights fall away only in limited circumstances: typically non-payment and insolvency events. As terms have become more restrictive, they have received greater scrutiny during the syndication process with certain components being subject to flex.

Transferability in relation to competitor restrictions and specifically around loan to own and distressed investors was a particular focus during 2018. A number of deals in 2018 contained a restriction on transfers to "competitors" or "industry competitors" with such terms being widely defined and the majority of these restrictions remained in place following events of default regardless of the nature or materiality of the event.

7 Asset Sales

The asset sales covenant does not operate to prohibit asset sales but rather provides a framework for ensuring borrowers receive cash and fair market value when disposing of their assets and either reinvest such cash in its business or reduce its debt.

European TLB	New York TLB
Unlimited asset sales subject to fair market value and 75% cash/cash equivalent	Unlimited asset sales subject to fair market value and 75% cash/cash equivalent. 75% minimum cash test sometimes measured in the aggregate over the life of the facility, rather than on a per transaction basis
Reinvestment rights of up to 365 days + 180 days (if committed)	Reinvestment rights of up to 365 days + 180 days (if committed)
The amount of net proceeds to be applied by borrowers in mandatory prepayment of its debt may step-down subject to certain leverage tests (with flex to remove leveraged based step-downs)	Many deals exclude sales up to a basket from fair market value and/or minimum cash requirements, and will often "deem" certain non-cash proceeds to be cash, up to a cap
The borrower may elect to prepay credit facility debt, *pari passu* debt secured by the same transaction security, senior secured debt and debt of non-guarantors	Similar

8 LIBOR

Following various scandals involving LIBOR manipulation and due to other policy concerns, the FCA announced in 2017 that LIBOR, which is intended to reflect the average rate at which major banks can obtain unsecured funding in the London interbank market in a specified currency for a particular period, will be replaced by alternative risk-free benchmark rates by 2021. Much work continues to be done in the financial markets to consult on, reform and replace LIBOR with suitable replacement reference rates: SONIA for sterling; SOFR for US dollar; ESTER for euros; SARON for Swiss francs; and TONAR for Japanese yen.

Methodologies for calculation of the different rates will be different: for example, SONIA is an unsecured rate, but SOFR is a secured lending rate. Publication times for each rate will also be different. Whereas LIBOR is a forward-looking rate for different maturities, the new risk-free rates are based on historical overnight lending rates. Regulators and benchmark administrators are consulting on term rates for SONIA and SOFR to minimise economic differences for market participants in calculating term risk and credit spread, as well as operational challenges in managing multicurrency cross-border transactions. In addition, transition to new risk-free rates is being dealt with in the financial markets along product lines; as a result, for example, hedging could be less effective if transition of the underlying obligation to a new benchmark rate does not occur at the same time and along the same lines as the related hedge.

New deals: At the time of writing, the new replacement benchmark rates are still being developed; it is not, therefore, possible to hardwire any replacement rates into loans being papered today and future amendments will be required. However, it is important to consider how to transition to a new benchmark rate once the loan market has decided on what that will be. Local regulators have been consulting on the triggers, timing and fallback provisions for applying replacement benchmark rates, advising parties to build sufficient flexibility into documents being entered into.

Legacy deals: Finance documentation referencing LIBOR on existing deals will need to be amended once the market has settled on a new replacement rate. Administration mechanics will also have to deal with future rate-setting in a multi-currency facility. For the time being, it is common for parties to loan agreements to incorporate additional flexibility into loan terms to allow for a new replacement benchmark rate to be agreed with a lower consent threshold in the future (often using the "Replacement of Screen Rate Clause" published by the Loan Market Association).

9 Direct Lending

In Europe, in the 12 months to the end of the second quarter of 2018, the Deloitte Alternative Deal Tracker has reported a 34% increase in direct lending deals as compared to the previous year. However, European fundraising was down 54% to $8.5 billion by the third quarter of 2018 compared to $18.7 billion in the same period of 2017 (in contrast to the US where fundraising doubled to $26 billion compared to $13 billion in the same period of 2017). The UK remains the leading source of direct lending deals in Europe, followed by France and Germany.

Direct Lenders increasingly compete with banks to finance the larger deals, of note in 2018 is the investment by Ares of £500 million (debt and equity) to support the acquisition of VetPartners by BC Partners and the debt package provided by Permira Debt Managers of approximately €250 million to RSK Group. Direct lenders continue to show a willingness to aggressively compete with banks on documentary terms (other than financial covenants, where direct lenders typically require at least a leverage covenant for term loan facilities), notably in 2018:

- in relation to debt incurrence, where direct lenders are willing to permit incremental facilities and a leverage-based cap; and
- transfer provisions, where direct lenders are willing to allow borrower consent for transfers to switch off on non-payment and insolvency events of default only, rather than any event of default.

In the US, the direct lending market has grown rapidly driven by bank capital limitations and investors searching for yield. The market is primarily controlled by business development companies (BDCs), private credit funds and middle market CLOs. Direct lending dry powder continued its multi-year trend of growing in 2018. The deepening of the direct lending market in North America continues to facilitate the rise of non-bank entities at the expense of traditional lenders. Institutional investors with long-term investor horizons have also pushed into the direct lending space (whether directly or through intermediaries) and we anticipate this trend continuing. In the next downward leg of the credit cycle, we anticipate that those platforms that have matched their asset and liability profiles appropriately and who have steady hands on the credit approval tiller will outperform and a consolidation of lesser names will occur. The rise of multi-asset managers continues, with debt platforms taking on equity investments, and equity platforms expanding into debt, including direct lending. 2018 saw newer entrants (often without deep origination platforms) stretching into the market to get deal flow, with more seasoned hands left scratching their heads as to the sustainability of the implied risk-return model as yields compressed and covenants eroded.

Origination is a key focus for direct lenders and in 2018 they have continued to build-on direct relationships with private equity sponsors and other platforms, in addition to teaming up with banks in order to gain access to their portfolio of corporate clients. A growing industry for direct lenders is technology, particularly where profits are low and recurring revenue rather than EBITDA-based financial covenants are prevalent, allowing direct lenders to demonstrate their more flexible and bespoke approach to covenant formulation.

10 Leveraged Lending Guidelines

The loan market has doubled in size since the 2008 financial crisis, leading regulators on both sides of the Atlantic to try to reduce systemic risk and persuade lenders into upholding credit standards by limiting loans that are seen as too risky.

The ECB's Guidance on Leveraged Transactions (which entered into force on 16 November 2017) is similar to the US Interagency Guidance on Leveraged Lending (which has been applicable to US-regulated banks since 2013, albeit with diminished status since a successful challenge that it had been invalidly promulgated as a rule). The two sets of guidance stipulate that underwriting loans where the ratio of total debt to EBITDA exceeds six times should be "exceptional" and should "raise concerns" for most industries. They also provide that banks should ensure borrowers can repay at least 50% of debt over a period of five to seven years.

It is interesting to note that even before the legal challenge to the status of the US Guidance, they had had little impact on deal leverage ratios or the proportion of deals in excess of 6×. Following the first anniversary in November 2018 of the introduction of the ECB's Guidance, no significant impact on leverage levels has been observed. Indeed, transaction leverage ratios increased slightly in 2018 from 2017 levels. According to LCD data, average debt: EBITDA on sponsor-backed transactions hit 5.7× in 2018 (up from 5.3× in 2017) – the highest on record since the 6.1× level reached at the height of the pre-crisis market in 2007. A number of deals in Europe in 2018 breached the 6× leverage level set by the ECB (notably the buy-outs of Akzo Nobel and Unilever at leverage levels of approximately 6.4× and 6.23×, respectively). This has led the Bank of England to warn of increasing systemic risks in the next economic downturn, exasperated by the prevalence of covenant-lite loans with fewer lender protections, which are then repackaged into CLOs and invested in widely across the financial markets.

Some investors are now calling on rating agencies and regulators to focus more on the impact of covenant-lite loans. With market commentators predicting a downturn in the financial markets, the lack of lender protections is expected to impact recovery rates. If default rates rise, then investors will find that restructurings are only triggered by payment defaults, as potential earlier triggers (*e.g.*, financial covenant breaches) are no longer market standard. The options for recovery may be more limited and, despite recent reforms, European insolvency laws do not generally protect enterprise value in the same way as Chapter 11 in the US.

11 IFRS 16 & ASC 842

Two new accounting rules for leases came into effect in recent months, which mean that, subject to certain limited exemptions, all leases of more than 12 months must be accounted for on companies' balance sheets, including operating leases, which were previously off-balance sheet liabilities. Companies applying IFRS are required to implement new rule IFRS 16 for fiscal years beginning on or after 1 January 2019. Public companies applying US GAAP are required to implement new rule ASC 842 for fiscal years beginning on or after 15 December 2018 while private companies applying US GAAP are required to comply with ASC 842 effective for fiscal years beginning on or after 15 December 2019, but may opt in now.

Both new rules will likely affect companies' assets, liabilities, interest expenses and EBITDA, particularly those in industries where operating leases are commonplace, such as retail and transportation.

- Underlying assets will be recognised as right-of-use assets on balance sheet, so depreciate over term of lease.
- Obligation to make lease payments will be a liability on balance sheet.
- Interest on leases will appear on income statement as finance expense.
- Depreciation in value of underlying asset will appear on income statement as a depreciation charge.

Affects:

- Capacity under debt, lien, restricted payments baskets, where they are expressed as a percentage of total assets or EBITDA.
- Capacity under leverage and coverage-based carve-outs.
- Compliance with leverage and coverage-based maintenance covenants (to the extent applicable), guarantor coverage tests and leverage-based margin ratchets.

It is expected that as affected companies begin to prepare new financial statements for accounting years ending in 2019, the impact from this accounting standards change will come to the fore. Loan agreements typically require borrowers to prepare financial calculations and statements in accordance with the relevant accounting standards used in the preparation of the original financial statements delivered at closing; *e.g.*, "frozen GAAP". In this instance, IFRS 16 and ASC 842 will have no effect on ongoing calculations prepared pursuant to a pre-existing loan agreement. The company will likely find itself having to satisfy both its legal requirement to produce financial statements in compliance with IFRS 16 or ASC 842 and its contractual requirement to produce statements to meet its obligations under the loan agreement. Effectively, this requires borrowers to keep two sets of financial statements – one set pursuant to the new rules and another hypothetical set "as if" the old rules applied, an approach, which, as time passes, is likely to become cumbersome.

Some loan agreements require the borrower to use IFRS or US GAAP in effect "from time to time" *e.g.*, "floating GAAP" – in this instance, calculations prepared pursuant to the loan agreement would need to give effect to IFRS 16 or ASC 842 as applicable. Companies with a significant number of operating leases could see its incurrence capacity greatly reduced. Alternatively, a rise in EBITDA, if not offset by the increase in debt, could increase the incurrence baskets of other companies.

Other loan agreements give borrowers the option to either freeze or use floating IFRS/GAAP, or to disregard the effects of either IFRS 16 or ASC 842 in its entirety for the purposes of financial definitions calculations. Lenders and borrowers will therefore need to approach potential covenant resets of documentary amendments on a case-by-case basis.

In the years ahead, borrowers and lenders negotiating loan agreements will likely focus on building additional room into baskets and other thresholds to accommodate the implications of balance sheet changes resulting from the new lease accounting rules. Given the dearth of experience interpreting the new rules, reaching consensus on an approach may prove challenging and borrowers may, for example, seek to shorten lease terms and more frequently renew them, in a bid to fall outside the rules. More broadly, the new rules may bring about an evolution in thinking about lease financing generally.

12 Foreign Guarantee/Pledge Issues

On 31 October 2018, the IRS released proposed regulations that generally would enable US borrowers to provide foreign collateral and guarantees in certain instances where they had previously been unwilling to do so. The proposed regulations reflect that, as a result of tax reform, under section 245A of the Internal Revenue Code, dividends paid by foreign subsidiaries to US parent corporations generally are no longer taxed. While the US still retains its idiosyncratic approach to global taxation, these changes are a welcome incremental move towards a territorial tax system. Historically, collateral packages excluded guarantees by controlled foreign corporations (CFCs) and limited pledges to 65% of any CFC voting stock to avoid triggering US corporate income tax as a deemed divided under section 956 (the "deemed dividend rule"). The proposed regulations provide that such guarantees and pledges will not give rise to a taxable deemed dividend in instances where an actual dividend would not have been taxed as a result of tax reform. Although the regulations are proposed only (and may be amended before being finalised), a corporate US borrower may rely on them so long as the borrower and all parties related to the borrower apply them consistently with respect to all CFCs of which they are US shareholders.

Despite the issuance of the proposed regulations, many borrowers continue to insist on including pre-tax reform language that prohibits guarantees by CFCs and limits pledges of equity interests to 65% of CFC voting stock. Borrower arguments for resisting foreign credit support include:

- it is still possible that income is taxable under section 956 if section 245A would not apply (*e.g.*, holding period rules and hybrid rules);
- possible state taxation if state incorporates section 956 but not section 245A;
- cost of providing foreign guarantees and pledges;
- guarantees by foreign subsidiaries could create issues under local law, such as financial assistance;
- proposed regulations may be withdrawn; and
- lenders historically have not asked for full foreign credit support even where no incremental tax cost.

13 Tenth Anniversary of Lehman Brothers Bankruptcy

"If money isn't loosened up, this sucker could go down", President George W. Bush declared on 25 September 2008.

It is worth remembering that Lehman Brothers filed for bankruptcy on 15 September 2008, as a result of the global financial crisis. We have now passed the 10-year anniversary and the seismic shock to the global financial system is slowly disappearing from recent memory. The colossal intervention by key central banks (through measures such as quantitative easing, bailout packages and toxic asset programs) saved us from the worst of the panic and created a solution (however imperfect) to a global crisis that imperilled us all. Ben Bernanke, former Chair of the US Federal Reserve, subsequently called it "the worst financial crisis in global history". Lest we forget…

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Our global Finance practice helps companies and lenders successfully navigate all aspects of the financing process and obtain the best outcomes, including financial institutions, alternative lenders, private equity sponsors and major corporations. We routinely handle cross-border financings and provide comprehensive advice to clients who need both bank and bond financings by creating tailored solutions to address particular financing needs, whether asset-based, leveraged or investment-grade.

Our leveraged finance team has the experience to advise on a broad range of products, from traditional bank finance, through to high yield bond offerings and private equity deals. Our clients turn to us for our in-depth understanding of the business and legal considerations involved in leveraged credits so they can navigate the challenges of today and achieve their future ambitions.

Chapter 6

Developments in Delayed Draw Term Loans

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Background – Delayed Draw Term Loans

As the number and volume of leveraged buyouts ("LBOs") by private equity sponsors have increased over the past few years, the financing structures for LBOs have continued to evolve, primarily to maximise the capital structure flexibility of the sponsor. While the fundamental loan components of any LBO continue to be term loans funded at closing (the "Closing Date") together with a revolving credit facility for liquidity and other needs, there has been a significant rise in the use of delayed draw term loans ("DDTLs"): loans which, similar to revolving facilities, are available to the borrower for drawing after the Closing Date but which, similar to term loans, may not be re-borrowed following prepayment. DDTLs must be drawn, if at all, during a specified commitment period following the funding of the initial term B loan ("TLB") on the Closing Date for the LBO. If drawn, the DDTL will mature on the maturity date for the initial TLB,[1] but, if not drawn during such period, any unused DDTL commitments will automatically terminate.

DDTLs have historically been a feature more characteristic of the middle market, with a sponsor/borrower seeking committed financing for an identified pending acquisition on a future date without incurring interest expense on that portion of the financing until actually needed and drawn. Since 2016, however, there has been a significant increase in the use of DDTLs in the large-cap syndicated leveraged loan market, with DDTLs being used to finance a broad range of transactions, including multiple opportunistic acquisitions. A number of factors appear to be driving this trend. First, private equity sponsors are increasing employing "buy and build" or "rollup" strategies, in which the sponsor purchases a "platform" company in a given industry with an experienced management team and developed infrastructure and then leverages those capabilities to consummate a series of "tack-on" acquisitions of industry competitors to build out a broad platform. Second, private equity sponsors have sought to utilise the momentum and fees of the LBO financing process to obtain committed financing for post-closing acquisitions and other activities without undergoing the time, expense and inconvenience of undertaking a new syndication soon after the initial closing – or, alternatively, borrowing an excess amount of TLBs on the Closing Date and paying the funded cost on the additional loans even before they are put to use.

The increasing demand for DDTLs from private equity sponsors has resulted in a renewed focus on the terms and economics of DDTLs. This article discusses several primary features of DDTLs in the syndicated leveraged loan market and explores issues to consider in this context.

Primary Features of DDTLs and Issues to Consider

Commitment Length and Use of Proceeds

Up until recently, if a DDTL appeared in the financing package for an LBO it would typically be to finance, or make payments in respect of, a single acquisition that had been disclosed to the lenders pursuant to an acquisition agreement in effect as of the Closing Date. In other words, the purpose of the DDTL was to bridge timing differences between the primary acquisition and a related but ancillary acquisition by the newly acquired company. Because the closing timing of the related acquisition was known as of the Closing Date, the DDTL commitment period was set to match the necessary timing (typically not more than three months) and the DDTL was limited to a single drawing during the commitment period to consummate the later acquisition.

In recent years, however, the permitted uses of a DDTL facility have greatly expanded to include: (i) financing multiple acquisitions, whether or not identified or identifiable to the lenders prior to the Closing Date; (ii) refinancing existing debt of the borrower maturing after the Closing Date but during the DDTL commitment period; (iii) financing unspecified capital expenditures/projects of the borrower; and (iv) replenishing balance sheet cash and/or repaying revolving facility borrowings previously used for any of the above purposes. As a result of this broader set of uses, commitment periods have correspondingly increased to as long as 18 months, with a typical DDTL commitment having a period of nine months. Moreover, while DDTLs historically were required to be drawn substantially contemporaneously with the acquisition, sponsors/borrowers have sought to maximise their flexibility by negotiating the ability to draw DDTLs so long as there is a "good faith expectation" that the proceeds will be used for a permitted acquisition.[2] To accommodate these multiple and sometimes evolving purposes that DDTLs now serve, sponsor/borrowers have sought the ability to borrow the DDTL facility in multiple drawings during that extended period to enable flexibility around the use of proceeds.

Conditions Precedent

Until recently, the use of DDTL proceeds was conditioned upon (i) the absence of any payment or bankruptcy event of default, (ii) the accuracy of customary "specified" representations and "acquisition agreement" representations, (iii) the substantially contemporaneous consummation of the acquisition being financed with the DDTL proceeds (and, if applicable, any equity contribution in connection therewith), and (iv) often, compliance with a maximum total and/or first lien net leverage ratio (most typically set at the level as of the Closing Date). Because, as noted above, DDTL proceeds were historically used to consummate an acquisition (pursuant to an existing acquisition agreement soon after the Closing Date), these standard conditions precedent made sense for both lenders and sponsors as they reflected the limited conditionality necessary to consummate such acquisition. Moreover, the presence or absence of a leverage ratio was less controversial for both lenders and sponsors/borrowers. From the lenders' perspective, because the acquisition structure and timing was known on the Closing Date, it was not unreasonable for lenders to forego any maximum leverage ratio condition. From the sponsor's/borrower's perspective, it was similarly, relatedly innocuous to agree to a maximum leverage ratio condition where the DDTL commitment period was relatively short, and therefore the ability to satisfy the leverage requirements was more certain.

More recently, however, the expanding uses of DDTL proceeds and corresponding lengthening of the DDTL commitment period have led to increased negotiation over the formerly customary conditions precedent to DDTL draw. On the one hand, given that in many transactions DDTL proceeds may now be used for a broad range of purposes other than acquisitions, lenders will want to ensure that, in such circumstances, conditions to the use of the DDTL include the making and accuracy of all representations and the absence of any event of default. On the other hand, the lengthening of the commitment period and the potential for borrowers to use DDTL proceeds for such broader purposes, including multiple, unspecified acquisitions, has led to increasing demand by sponsors to remove any maximum leverage ratio condition given that the ability to comply with such ratio, and thus access the DDTL, is at best uncertain (and more likely unknown) at the time of closing. Unsurprisingly, recent deals are mixed on the scope of representations and defaults and on whether compliance with a maximum leverage ratio is required to use DDTL proceeds.

Ticking Fees

As DDTL commitment periods continue to lengthen, there has been an increased focus on the economics of DDTL arrangements, most notably the structure of the "ticking fees". DDTL ticking fees are similar to revolving facility commitment fees in that they accrue on the undrawn portion of the DDTL commitment until the earliest to occur of (i) the date the DDTL facility is fully utilised, (ii) the date the borrower terminates the DDTL commitments, and (iii) the last day of the DDTL commitment period (on which the DDTL commitments automatically terminate) (such earliest date, the "DDTL Termination Date"). DDTL ticking fees are most typically paid quarterly in arrears following the Closing Date and on the DDTL Termination Date.[3] The primary purpose of ticking fees is to provide arrangers of DDTL financings with sufficient economics to syndicate the DDTL commitments to institutional lenders in advance of the funding of the DDTL (the "DDTL Funding Date") and hold the syndicate together through the availability period. Ticking fees most typically accrue following a 30–60-day "holiday" following the Closing Date and through the DDTL Termination Date. The ticking fee percentage generally steps up every 30–60 days from an initial level of 50% of the interest rate margin that would apply to a funded DDTL to 100% of such margin *plus* then applicable LIBOR (often inclusive of any applicable LIBOR "floor"). In many transactions, arrangers will, as part of any implementation of their "market flex" rights, require that the DDTL ticking fee (i) step up immediately to 100% (rather than 50%) of the interest rate margin following the specified holiday, (ii) be subject to an accelerated schedule of step-ups to 50% and 100%, and/or (iii) not be subject to any holiday. In the event the syndication of the TLB (and DDTL commitments) extends beyond the Closing Date (and the Closing Date, therefore, occurs before the pricing of the DDTL has been finally determined), the calculation of the interest rate margin will often give effect to the maximum potential increase in the spread after exercise of any available "market flex" rights.

It is worth noting that this "holiday-then-step-up" structure of any post-Closing Date DDTL ticking fee may create some interesting anomalies in the overall ticking fee structure. For example, LBOs with commitments of six months or longer typically require that the borrower pay committing TLB lenders a ticking fee on the undrawn commitments ***prior*** to the Closing Date (following a similar holiday and step-up schedule). Similar to ***post-closing*** DDTL ticking fees, the pre-closing ticking fees are intended to compensate institutional lenders for providing commitments at preferential pricing (well) in advance of the Closing Date. Where there is a DDTL in the financing structure, any pre-closing ticking fee will similarly be payable on the undrawn DDTL commitments. In that case, a lender who has been accruing a ticking fee on its DDTL commitment equal to, say, 100% of the DDTL interest rate margin on the day before the Closing Date may find that it is receiving no ticking fee on that same DDTL commitment for the next 30–60 days after the Closing Date.

Upfront Fees

Upfront fees are payable to lenders on the Closing Date of nearly every TLB financing as a percentage of the principal amount of the TLB actually funded to the borrower. Upfront fees are either reflected as "original issue discount" on the TLB or as a separate fee paid by the borrower, but, in practice, are paid through a "net-funding" mechanism, whereby lenders reduce the amount actually advanced to the borrower by the upfront fee. Under either structure, the borrower owes the full stated principal amount of the TLB to the lender at maturity.

In the DDTL context, deals are mixed as to whether DDTL upfront fees are paid on the Closing Date (similar to customary commitment fees) or only on, and subject to the occurrence of, funding on any DDTL Funding Date. In transactions where DDTL upfront fees are payable on amounts funded on a DDTL Funding Date, such fees are netted against the portion of the DDTL facility actually funded on the DDTL Funding Date.[4] This arrangement reflects the usual practice for paying upfront fees on term loans in LBO finance: that the borrower pays upfront fees only when those term loans are actually funded.

Where DDTL upfront fees are payable on the Closing Date, both the upfront fee on the initial TLB and on the DDTL are netted against the initial TLB funded at closing. In contrast to the general rule stated above – upfront fees on LBO term loans are payable only when those term loans are funded – lenders retain the full DDTL upfront fee even where the DDTL facility ultimately may not be drawn in full (either because the borrower elects to terminate DDTL commitments prior to the DDTL Funding Date or the commitment period expires prior to the funding in full of the DDTL). While borrowers often agree to pay DDTL upfront fees on the Closing Date as a necessary condition to obtaining DDTL commitments, this may result in a potential windfall to lenders who are paid upfront fees on DDTL commitments that may never be funded. Nevertheless, given the fact that, in recent deals, both the initial TLB and DDTL are almost always syndicated simultaneously to the same institutional lenders, arrangers will often insist that DDTL upfront fees be payable on the Closing Date in order to ensure a successful syndication process by guaranteeing lenders a minimum level of economics on both tranches of term loans.

Fronting Arrangements

Traditionally, where more than one arranger commits to provide a TLB in advance of closing, the actual funding of the TLB on the Closing Date will be "fronted" by the administrative agent (the "Fronting Lender") on behalf of the other arrangers (the "Other Arrangers"). The fronting mechanism is particularly useful in the LBO context, where there are often multiple arrangers and the TLB proceeds are needed early on the Closing Date to meet the acquisition closing timing. Such fronting arrangements are typically documented pursuant to a "fronting letter", under which the Fronting Lender agrees to fund the entire TLB in exchange for the agreement of each Other Arranger to purchase its *pro rata* portion of the TLB after a specified period (typically 30–45 days) following the Closing Date to the extent that the Fronting Lender has been unable to assign any portion of the TLB to institutional lenders who had agreed, prior to the Closing Date, to purchase their allocated portion of the TLB.[5]

The increasing presence of DDTLs in financing structures for LBOs has led to practical questions regarding how the DDTL in any LBO should be funded. Historically, arrangers held the DDTL commitments until the applicable DDTL Funding Date. In such cases, consistent with the Closing Date arrangements, the Fronting Lender "fronted" the DDTL on behalf of the Other Arrangers pursuant to either (i) the Closing Date fronting letter, which applied to both the initial TLB and DDTL commitments, or (ii) a separate fronting letter entered into on the DDTL Funding Date applicable solely to the funded DDTL.[6] Each of these approaches was effective, in part, because, while the TLB was assigned to institutional lenders shortly following the Closing Date, the DDTL commitments were retained by the Fronting Lender and the Other Arrangers until the DDTL Funding Date.

In recent years, however, given the lengthening of DDTL commitment periods, it has become increasingly common for arrangers to assign the DDTL commitments concurrently with the initial TLB to institutional lenders as part of a single "strip" following the Closing Date.[7] In such cases, practical issues arise at the time of each funding of the DDTL due to the fact that the lenders holding DDTL commitments on the DDTL Funding Date (the "DDTL Lenders") comprise a broad syndicate of institutional lenders. An institutional lender is often limited in its ability to fund its DDTL commitments on the DDTL Funding Date as a result of internal legal, regulatory and operational constraints. But even if the DDTL Lenders have no other limitations on their ability to fund on the DDTL Funding Date, the number of DDTL Lenders in a particular syndicate may make it impracticable to rely on the DDTL syndicate to fully fund the DDTL loan to meet the timing requirements of the borrower's related acquisition or other transactional need. If, as a consequence, one or more of the arranger banks or the administrative agent undertakes the responsibility to prefund the DDTL, that funding bank will in turn need an agreement with the DDTL Lenders to properly allocate the DDTL after its funding. A standard fronting letter among the arrangers will not be sufficient to facilitate fronting arrangements on the DDTL Funding Date as the DDTL commitments are held by the broader institutional lender syndicate, not the arrangers.

An approach to addressing these concerns is to include "fronting" language in the credit agreement itself permitting the administrative agent to act as a "fronting lender" for the DDTL commitments in the same way it customarily does for undrawn revolving commitments. Specifically, the administrative agent will make the DDTL on behalf of the DDTL Lenders and each DDTL Lender will, in turn, agree to fund its *pro rata* share of the DDTL borrowing (together with interest) to the administrative agent within a specified period (e.g., 10–15 business days) following the DDTL Funding Date. To the extent any DDTL Lender fails to fund its *pro rata* portion within that period, the credit agreement will require the borrower to prepay the fronted amount to the agent.[8] This arrangement is somewhat peculiar in that, unlike Closing Date fronting arrangements, the agent fronting a fully syndicated DDTL will have "de-risked" its DDTL exposure during the post-closing assignment process. The agent thus assumes the risk that a DDTL Lender will fail to fund its *pro rata* share of the borrowing and the borrower, in turn, will fail to reimburse the agent for the shortfall. A potential way to mitigate this risk is to have each Other Arranger agree to reimburse the agent for its *pro rata* share of the DDTL (calculated as of the signing date) to the extent both a DDTL Lender and the borrower fail to fund. It is important that any such "risk-sharing" arrangement be addressed in the Closing Date fronting letter when the agent and Other Arrangers still hold DDTL commitments, since, once the DDTL has been assigned in full, the Other Arrangers may have little incentive to agree to share the fronting risk of the DDTL.[9]

Conclusion

Given that DDTLs are an increasingly important financing tool for sponsors looking to consummate post-closing acquisitions and other activities, we expect to see a continued push of the historical boundaries in DDTL terms – including increasing the DDTL commitment length and expanding the scope of uses of DDTL proceeds – as well as a continued focus by market participants on whether DDTL upfront fees should be payable upon closing or funding. With the increasing frequency of DDTLs in financing structures and the market shifting towards a simultaneous assignment of the initial TLB and DDTL commitments to the same lenders, we also expect further consensus on how best to address DDTL funding arrangements.

Endnotes

1. In nearly all cases, upon funding, the DDTL will be required to have terms identical to, and be treated as a single "fungible" class with, the initial TLB.
2. Where lenders are reluctant to agree to such flexibility, a potential compromise is to require the prepayment of the funded DDTL to the extent the acquisition is not consummated within an agreed timeframe following the Closing Date.
3. We note that in a minority of transactions, ticking fees, similar to certain upfront fees, are payable by the borrower solely to the extent the DDTL is funded.
4. In such cases, lenders sometimes have the ability to make the DDTL upfront fee payable on the Closing Date instead of the DDTL Funding Date as part of implementing any "market flex".
5. In practice, arrangers will require the borrower to pre-consent to these assignments pursuant to a "master consent" entered into on the Closing Date, which lists all institutional investors forming part of the primary syndication of the TLB facility.
6. In either case, it is important that the borrower's consent to assignees of the initial TLB and DDTL on the Closing Date (pursuant to the master consent to assignment) apply during both the assignment process for the initial TLB following the Closing Date as well as the assignment process for the DDTL following the DDTL Funding Date.
7. Note that where both initial TLB loans and DDTL commitments will be syndicated simultaneously following the Closing Date, the master consent to assignments should expressly permit the assignment of both "loans" and "commitments" to the agreed assignees.

8. Even without this specific language in the credit agreement, under certain credit agreements, parties may be able to rely on the standard credit agreement provision permitting the agent to front loans for other lenders (so long as such language is not limited to revolving borrowings).
9. Of course, Other Arrangers may object to participating in the agent's fronting risk with respect to the DDTL even in cases where they are asked to share such risk on the Closing Date, as their expectation is that they are fully de-risked of the DDTL as of such date.

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Commercial Lending in a Changing Regulatory Environment, 2019 and Beyond


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While the Trump Administration's deregulatory initiatives continue apace in many areas, change in the banking area in the US remains comparatively modest. Although the banking agency Leveraged Lending Guidance has ceased to be central to the debate about that market, the banking agencies and other policy makers and commentators continue to express concerns about potential risk in the leveraged loan market, particularly in the event of a downturn prompted by other structural challenges. At the same time, it is far less clear than it might have been before the 2008 financial crisis that those risks are predominantly faced by banks. Non-bank participants are ever more important as investors in those markets and may, at least indirectly, be responsible for the decline in the rigour of covenants. Further, such market participants – and even many of the banks – may not have the incentive or resources to engage with borrowers in restructuring efforts, instead leaving that role to relatively more aggressive late stage investors with a greater inclination to pursue extreme tactics. However, many commentators have been careful to draw distinctions between concerns about the increasing potential for credit losses and other vulnerabilities of the loan market and broader systemic risks, noting in particular that banks generally have a smaller share of the market and better pipeline management than in years past.

In a somewhat challenging economic environment, the Federal Reserve has chosen to taper down the balance sheet normalisation process, not only with a view to mitigating deflationary pressure, but in an effort to right-size the availability of reserves necessary to help banks satisfy applicable liquidity requirements by ensuring a stable source of reserve, as well as helping the Federal Reserve to ensure emergency liquidity needed by banks facing potential distress.

Leveraged Lending After the Leveraged Lending Guidance

In October 2017, the federal Government Accountability Office (**GAO**) confirmed Senator Pat Toomey's view that the Leveraged Lending Guidance[1] (adopted by the key federal banking agencies who share responsibility for supervision of the banking sector: the Board of Governors of the Federal Reserve System (**FRB**)[2]; the Office of the Comptroller of the Currency (**OCC**)[3]; and the Federal Deposit Insurance Corporation (**FDIC**,[4] and together with the FRB and the OCC, the **Agencies**)) is potentially subject to legislative repeal under the U.S. Congressional Review Act.[5] Senior House Financial Services Committee member Blaine Luetkemeyer reacted to the GAO's conclusion by writing to the Agencies to inquire as to their plans with respect to the Leveraged Lending Guidance. It was widely reported that the Agencies responded to Representative Luetkemeyer by suggesting that the Guidance would be revisited.

In May 2018, Comptroller of the Currency, Joseph Otting, observed that the Leveraged Lending Guidance was just "guidance" and banks could occasionally operate outside those parameters, but would still bear the burden of demonstrating that their loans are prudent.

Banks continue to be involved in this market and, as is reflected in the recent Shared National Credit Program 1st and 3rd Quarter 2018 Examinations Review,[6] the Agencies are still troubled, observing that the "[r]isks associated with leveraged lending activities are building in contrast to the portfolio overall. Leveraged loans with supervisory ratings below pass typically reflect borrowers with higher than average leverage levels and weaker repayment capabilities".[7] The SNC 2018 Review found that many leveraged loan transactions had weaker transaction structures and increased reliance upon revenue growth or anticipated cost savings and synergies to support borrower repayment capacity. The agencies also point to the anomalous influence that borrowers in this market possess over lending relationships, noting that this too is likely a factor contributing to growing risk in the sector.

The SNC 2018 Review did, however, conclude that agent banks' risk management and underwriting practices have improved in some respects since 2013 and that agent banks are better equipped to assess borrower repayment capacity and enterprise valuations, as well as having developed other risk management processes that better align with safety and soundness principles. But at bottom, the SNC 2018 Review indicates that the Agencies do not think that these improvements are in themselves sufficient to address changing conditions and increased layering of risk.

A number of commentators, including the FRB, have cited Moody's Investors Service research as a validation that, although spreads remain at the lower level of their range since the end of the financial crisis, the covenant quality of North American leveraged loans is close to its all-time record worst and is continuing to weaken. Moody's Loan Covenant Quality Indicator (**LCQI**), which tracks the degree of overall investor protection in the covenant packages of individual speculative-grade leveraged loans issued in the US and Canada on a two-quarter rolling average basis, measured on a scale of 1 to 5 (with 5 denoting the weakest from investor protections),[8] ended the second quarter 2018 at 4.09,[9] against 4.05 at the end of the first quarter. The following quarter was just one basis point away from its lowest point, reached in the third quarter of 2017.[10]

Even the IMF, in its Global Financial Stability Report 2018, cites the risk of reduced spreads and a higher LCQI as a source of risk that could result in an untoward market adjustment.[11] Echoing the findings of the FRB Report with respect to the US market, the IMF Report highlights that origination of the share of leveraged loans of total corporate origination in Europe is now rivalling levels in the US, with a relatively higher percentage of loans evidencing leverage multiples of 5 or more.[12]

The SNC 2018 Review evidences the Agencies' continuing focus on assessing the impact of these layered risks of weaker transaction structures and covenants and their belief that a downturn in the economy could result in a significant increase in classified exposures and higher losses. In the SNC 2018 Review, the Agencies enjoin banks engaged in originating and participating in leveraged loans to ensure that risk management processes keep pace with changes in the leveraged lending market and ensure that their risk management processes and limits fully consider the potential direct and indirect risks associated with these loans. In particular, the Agencies have said that they expect lenders:

(i) To understand and reasonably support the borrowers' ability to achieve revenue growth or anticipated cost savings and synergies when underwriting and risk rating these credit facilities.

(ii) To ensure that planned and permissible incremental facility use is fully incorporated into measures that control origination and participation activities, recognising that usage of incremental facilities shortly after funding may materially alter repayment capacity estimates and could adversely affect facility risk ratings.

(iii) To ensure that stress testing models account for market changes as recovery rates may differ from historical experience.

A blog posted on the IMF website highlights some of the specific risks associated with weaker covenants:

> For example, weaker covenants have reportedly allowed borrowers to inflate projections of earnings. They have also allowed them to borrow more after the closing of the deal. With rising leverage, weakening investor protections, and eroding debt cushions, average recovery rates for defaulted loans have fallen to 69 percent from the pre-crisis average of 82 percent. A sharp rise in defaults could have a large negative impact on the real economy given the importance of leveraged loans as a source of corporate funding.[13]

Weaker covenants and creditor protections are expected to have the effect of delaying defaults and therefore inhibiting lender efforts to intervene earlier to try to remediate troubled credits. Specifically, borrowers commonly have opportunities to incur additional debt without lender consent, through incremental facilities, and to inflate EBITDA (earnings before interest, tax, depreciation and amortisation, used as a measure of cash flow potentially available for debt service and as a basis for calculating leverage and covenant baskets) by incorporating adjustments or "addbacks" for items such as cost savings and synergies, leading to additional debt capacity. As has been demonstrated in credits such as J. Crew, PetSmart, and Neiman Marcus, looser covenants may give the Borrower the freedom, in a tactic colloquially referred to as "collateral stripping", to weave a path through the exceptions to the restricted payment and investment covenants to move assets out of the restricted group of guarantor subsidiaries free of lien – and out of the collateral package that the lenders had expected to be able to rely on for credit support.

As noted in the paper *Covenant-Light Contracts and Creditor Coordination*, "financial covenants are intended to serve as triggers to renegotiation: covenant violations shift control toward creditors",[14] but fail to serve this function adequately when borrowers are able to implement tactics such as those described above. But the paper suggests that, more than evidencing the influence that borrowers in this market possess over lending relationships, weaker covenants may reflect the increasing involvement in the leveraged loan market of comparatively passive investors resembling the holders of public bonds. In the hands of such investors, the authors suggest, "loan contract covenants intended to lead to renegotiation become less attractive, and one should expect more bond-like (cov-lite) contracts, as well as a lower cost of such features".[15] Implicitly, such investors would rather sell the exposure than engage in relatively costly negotiations with borrowers designed to remediate any distress.

The SNC 2018 Review confirms the changing character of investors in the market, noting that non-bank entities have increased their participation in the leveraged lending market via both purchases of loans or direct underwriting and syndication of exposure. Thus, the SNC 2018 Review concludes that more leveraged lending risk is being transferred to these non-bank entities, a factor that some associate with declining market discipline.

The inference that weaker covenants are a product of the increased participation of relatively passive investors has an empirical foundation. And while the FRB observes that levels of non-agency securitisations (instruments not guaranteed by a government-sponsored enterprise or by the federal government) have been rising in recent years, the FRB notes that gross issuances of CLOs, which are predominantly backed by leveraged loans, hit $71 billion in the first half of 2018, an increase of one-third compared to the preceding year, and that CLOs now purchase about 60 percent of leveraged loans at origination.[16]

While not so large a contributor to non-bank holdings of leveraged loans, according to the FRB Report, loan mutual funds purchase about one-fifth of newly originated leveraged loans. Because the holders of such funds are ordinarily entitled to redeem on one-day notice and loans may require longer periods for sales, mutual funds are conceivably subject to runs. A race to redeem shares could lead to large sales of relatively illiquid loans, exacerbating price declines and run incentives.[17] The FRB Report expresses concerns that such valuation pressures may make large price adjustments more likely, potentially motivating investors to quickly redeem their shares.

In a credit crunch, not only are weaker covenants likely to delay or impede the workout process, but the investors holding such loans are likely to flee the credit in favour of participants who may be more aggressive in the workout process as a result of having purchased exposures at significant discounts. It is unlikely that mutual funds will continue to hold leveraged loans issued by borrowers experiencing distress – and there may be powerful incentives for CLOs to exit from their exposure to deteriorating credits by selling out. Even banks, which already have a relatively low exposure to such credits, may also be more likely to sell out than engage in the resource-intensive workout process, particularly since regulators are likely to force aggressive mark-downs on troubled loan exposures. While banks at one time played a significant role in the workout process, not only has the share of leveraged loans held by banks declined, but banks have also become more likely to join passive investors in selling down their exposures. All of these factors, together, reinforce the expectation that such loans are likely to offers recoveries that are less good than historic norms, and that workouts of leveraged loans may be increasingly dominated by aggressive private funds.

Federal Reserve Balance Sheet Normalisation Policy: Response to the Expanded Demand for Federal Reserve Bank Reserve Balances

There has been considerable discussion since enactment of Dodd-Frank of the impact on bank balance sheets and the propensity of banks to engage in credit creation as a result of the Basel III Liquidity Coverage Ratio (**LCR**) and inhibitions on the power of the Federal Reserve System to grant short-term credit to banks in distress. As the Federal Reserve System weighs whether and how much to downsize its balance sheet in the wake of substantial quantitative easing in response to the financial crisis, it has moderated its earlier guidance regarding the conditions under which it could adjust the details of its balance sheet normalisation program. While the reserves have already declined appreciably from their peak, falling by $1.2 trillion to the current level of around $1.6 trillion, the Federal Open Market Committee (**FOMC**) announced on January 30, 2019, that:

> The Committee intends to continue to implement monetary policy in a regime in which an ample supply of reserves ensures that control over the level of the federal funds rate and other short-term interest rates is exercised primarily through the setting of the Federal Reserve's administered rates, and in which active management of the supply of reserves is not required.
>
> The Committee continues to view changes in the target range for the federal funds rate as its primary means of adjusting the stance of monetary policy. The Committee is prepared to adjust any of the details for completing balance sheet normalisation in light of economic and financial developments. Moreover, the Committee would be prepared to use its full range of tools, including altering the size and composition of its balance sheet, if future economic conditions were to warrant a more accommodative monetary policy than can be achieved solely by reducing the federal funds rate.[18]

In 2014, the Agencies jointly adopted a final rule implementing a "liquidity coverage ratio" (**LCR**) applicable to large, internationally active banking organisations, certain designated non-bank financial companies, and certain consolidated subsidiary depositary institutions thereof (**LCR Rule**). The LCR Rule is expressly patterned on the international standard established by the Basel Committee, albeit with some adjustments to reflect the unique characteristics of the US market and US regulatory scheme. Thus, the LCR Rule imposes a somewhat more stringent requirement than the Basel Committee's framework. In broad strokes, the LCR Rule requires subject entities to maintain a minimum LCR, defined as the ratio of unencumbered "high-quality liquid assets" (**HQLA**) to "total net cash outflows", over a prospective period of 30 calendar days, a form of standardised stress test scenario. The question posed by the LCR Rule to subject institutions is as follows: Assuming that cash outflows over the coming period are large and cash inflows are weak, does the bank have sufficient readily liquefiable assets to weather the storm?

Depending on the size and activities of the subject entity, the LCR Rule imposes two distinct requirements, referred to herein as the "**Full LCR**", applicable to large, internationally active banking organisations, and the "**Modified LCR**", applicable to other large bank or savings and loan holding companies that in the Agencies' view pose less severe systemic risks. The LCR Rule became effective on January 1, 2015.

The LCR improves the liquidity resilience of banks by requiring them to hold sufficient high-quality liquid assets to cover potential outflows during times of stress, but has a high opportunity cost. Reserves held with Federal Reserve Banks, along with Treasury securities, are favoured under the LCR. Firms currently meet a sizable fraction of their LCR requirements by holding reserves. The Federal Reserve manages the level of the federal funds rate and other short-term interest rates primarily through the use of administered rates, including the rate paid on reserve balances and the offered rate on overnight reverse repurchase agreements.

In a speech on *The Future of the Federal Reserve's Balance Sheet* given by FRB Vice Chairman for Supervision Randal K. Quarles,[19] Vice Chairman Quarles observed that the Federal Reserve would work to maintain a quantity of reserves necessary to remain reliably on the flat portion of the reserve demand curve. This amount would likely reflect a balance somewhere between the industry's expected demand for reserves in the neighborhood of $800 billion and an average supply of reserves large enough to keep the federal funds rate determined along the flat portion of the reserve demand curve even with an unexpected shift in the supply of or demand for reserves. In the Vice Chairman's view:

> This approach would be operationally convenient but would also leave the size of the balance sheet and reserves larger than necessary most of the time. In my view, it might be appropriate for us to operate somewhere in between these two extremes, with a sizable quantity of reserves large enough to buffer against most shocks to reserve supply. On those few days when that buffer is likely to be exhausted, we could conduct open market operations to temporarily boost the supply of reserves.

The FOMC's substantial reduction in the pace of the decline in reserves will allow a gradual convergence to the optimal level of reserves.

By providing assurance that an ample supply of reserves will remain available to the banking system, the Federal Reserve not only softens the potentially depressing effect of potentially costly LCR requirements, but reduces the likelihood of possibly destabilising liquidity shortages in the banking sector, while possibly mitigating deflationary tensions and dampening the disincentives on credit creation.

Endnotes

1. FDIC, FRB, OCC, Interagency Guidance on Leveraged Lending, 78 Fed. Reg. 17766 (March 22, 2013).
2. The FRB is the central bank of the United States and also has supervisory and regulatory oversight of bank holding companies, their non-bank subsidiaries, state banks that are members of the Federal Reserve System, state regulated branches and agencies of foreign banks, and foreign banking organisations that are treated as bank holding companies as a result of having a branch, agency or commercial lending subsidiary.
3. The OCC, an independent division of Treasury, has supervisory and regulatory oversight of national banks, which includes many of the Nation's largest banks, and federal branches of foreign banks.
4. The FDIC insures the deposits of FDIC member banks and has supervisory and regulatory oversight with respect to state banks that are not members of the Federal Reserve System.
5. Title II, Subtitle E. of the *Contract with America Advancement Act of 1996*, Pub L. 104–121, creates a mechanism through which an agency statement of general or particular applicability and future effect designed to implement, interpret, or prescribe law or policy is subject to review and possible disapproval by Congress and the President. At the request of Senator Toomey, the GAO concluded that the "[t]he Interagency [Leveraged Lending] Guidance is a general statement of policy designed to assist financial institutions in providing leveraged lending to creditworthy borrowers in a sound manner. As such, it is a rule subject to the requirements of [Congressional Review Act]." GAO, *Applicability of the Congressional Review Act to Interagency Guidance on Leveraged Lending* (October 19, 2017), *avail. at* https://www.gao.gov/products/D17915.
6. FDIC, FRB, OCC, Shared National Credit Program 1st and 3rd Quarter 2018 Examinations (January 2019) (**SNC 2018 Review**), *avail. at* https://www.occ.gov/news-issuances/news-releases/2019/pub-snc-review-2018.pdf.
7. SNC 2018 Review, at 3.
8. *Id.*
9. The LCQI measure is a somewhat challenging basis for assessing a broad market, because a decline in lending to the very worst leveraged credit borrowers, resulting in an improvement of the overall credit quality of originations, could result in an increase in the LCQI because the relatively stronger credits are able to negotiate comparatively weaker covenants.

10. FRB, Financial Stability Report (November 2018), at 12 (**FRB Report**), *avail. at* https://www.federalreserve.gov/publications/files/financial-stability-report-201811.pdf.
11. IMF, Global Financial Stability Report: A Decade After the Global Financial Crisis, Are We Safer? (October 18, 2018), at 11 (**IMF Report**).
12. *Id.*, at 8.
13. Tobias Adrian, Fabio Natalucci, and Thomas Piontek, Sounding the Alarm on Leveraged Lending, *avail. at* https://blogs.imf.org/2018/11/15/sounding-the-alarm-on-leveraged-lending/.
14. Becker & Ivashina, *Covenant-Light Contracts And Creditor Coordination (2016)*, at 3, *avail. at* https://www.hbs.edu/faculty/Publication%20Files/SSRN-id2756926_fccde84f-d333-4569-8fb1-2aa387a2e403.pdf.
15. *Id.*, at 4. The author's research suggests that "[a] 5% increase in the ownership stake of mutual funds and CLOs is associated with a 3.2% increase in the likelihood of cov-lite structures (about half of the unconditional average); a 2.0% drop in the likelihood that the loan amortizes before maturity (about half of the unconditional average); and a 0.2-year increase in loan maturity (the mean maturity is around 4.5 years)".
16. FRB Report, at 29.
17. *Id.*, at 34.
18. https://www.federalreserve.gov/newsevents/pressreleases/monetary20190130c.htm.
19. Vice Chairman for Supervision Randal K. Quarles, Speech, The Future of the Federal Reserve's Balance Sheet (February 22, 2019) at the 2019 U.S. Monetary Policy Forum, sponsored by the Initiative on Global Markets at the University of Chicago Booth School of Business, New York, New York, *avail. at* https://www.federalreserve.gov/newsevents/speech/quarles20190222a.htm.

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Acquisition Financing in the United States: Will the Boom Continue?

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Acquisition financing continues to be robust in the United States, as indicated by the number of leveraged loans issued in 2018. Financing was available through a multitude of financing sources, such as covenant-lite term loan facilities, high-yield bonds, middle market term loans, cash flow revolving facilities, and asset-backed revolving facilities. Furthermore, in 2018 we saw that banks were eager to issue investment grade loans in support of major acquisitions by investment grade, levered and private equity buyers.

Highlights from 2018 included a $38 billion financing commitment obtained by T-Mobile in support of its merger with Sprint, $26.7 billion of bridge commitments, $20.0 billion of senior notes and $6.3 billion of bank facilities by Cigna to fund its acquisition of Express Scripts, and $20.3 billion of loan facilities by Broadcom to fund its acquisition of CA Technologies.

Indicators suggest that the boom should continue in 2019. Dealmakers are optimistic because of the tax reform, a more relaxed US regulatory climate, and growing cash reserves. Furthermore, many industries, such as technology, media and telecommunications, are ripe for consolidation.

However, there are reasons for caution. For instance, low investment grade bonds now constitute more than half of the investment grade market. If another recession were to occur, companies who barely made the cut could be pushed out of the investment grade class. In addition, if interest rates continue to rise, companies may borrow less.

Nonetheless, acquisition financing will likely continue to be strong and the need for acquisition financing should continue to be strong. It is important to review the fundamentals of U.S. acquisition financing using secured loans and monitor trends in this regularly changing area of financing.

The Commitment Letter is Key

The commitment letter for a financing includes the material terms of the lenders' obligations to fund the loans and the conditions precedent to such obligations. Obtaining a suitable commitment letter from one or more lenders is of particular importance to acquisition financing and can be the deciding factor as to whether a seller will sign an acquisition agreement with a particular buyer where the buyer cannot otherwise prove itself able to fund the acquisition from its own funds. As in all committed financings, the borrower wants an enforceable commitment from its lenders which obligates the lenders to extend the loans, subject to certain conditions that have been mutually agreed upon. In acquisition financing, where the proceeds of the loans will be used by the borrower to pay the purchase price for the target company, in whole or in part, the seller will also be concerned whether the buyer has strong funding commitments from its lenders. If the buyer's lenders do not fund the loans, a failed acquisition could result.

In a typical timeline of an acquisition, especially one involving public companies, the buyer and seller execute the definitive agreement for the acquisition weeks, if not months, in advance of the acquisition. Following execution, the buyer and seller work to obtain regulatory approvals and other third-party consents that may be needed to consummate the acquisition, execute a tender offer if required, complete remaining due diligence, finalise the financing documentation and take other required actions.

Signing an acquisition agreement often results in the seller not pursuing other potential buyers for a period of time while the parties work to complete the items noted in the prior sentence. For example, acquisition agreements routinely contain covenants forbidding the seller from soliciting or otherwise facilitating other bids and requiring the parties to work diligently towards closing. Further, many acquisition agreements either do not give the buyer a right to terminate the agreement if its financing falls through (known as a "financing-out" provision), or require a substantial penalty payment to be made by the buyer if the transaction fails to proceed, including as a result of the financing falling through (known as a "reverse break-up fee"). Accordingly, at the signing of the acquisition agreement, and as consideration for the buyer's efforts and costs to close the acquisition, the buyer will want the lenders to have strong contractual obligations to fund the loans needed to close the acquisition.

Who Drafts the Commitment Letter?

Private equity funds (also known as sponsors) are some of the most active participants in M&A transactions and related financings. With their sizable volumes of business that can be offered to banks, sponsors often have greater leverage in negotiations with lenders than non-sponsor-owned companies. Sponsors and their advisors monitor acquisition financings in the market and insist that their deals have the same, if not better, terms. As economic tides shift, the ability of sponsors to leverage their large books of banking business grows and wanes, and the favourability for sponsors of acquisition financing terms shift as well.

Who drafts the commitment papers is one area where sponsors are often treated more favourably than other borrowers. While lenders in most cases expect to draft commitment papers, the larger sponsors are now regularly preparing their own forms of commitment papers and requiring the lenders to use them. From the sponsors' perspective, controlling the drafts can result in standardised commitment letters across deals, and a more efficient and quick process to finalise commitment letters. To get the best terms, the sponsors often simultaneously negotiate with a number of potential lenders and then award the lead role in an acquisition financing to the lender willing to accept the most sponsor-favourable terms.

Conditionality

The buyer's need for certainty of funds to pay the purchase price puts sharp focus on the conditions that must be met before the lenders are contractually obligated to fund the loans. As a result, a buyer has a strong preference to limit the number of conditions precedent in a commitment letter, and to make sure that the commitment letter is explicit as to the included conditions, in order to enhance funding certainty. The buyer and seller want to avoid a scenario where the conditions precedent to the buyer's obligation to close the acquisition has been met but the lenders' obligation to fund the loans has not. Particularly in the scenario where no financing-out clause is included in the acquisition agreement, if the acquisition financing falls through because the buyer cannot satisfy the conditions in the commitment letter, the buyer may not be able to close the acquisition and could be required to pay the seller sizable contractual breakup fees and be subject to lawsuits from the seller. Certain conditions discussed below are commonly subject to heavy negotiation in an acquisition financing.

Conditions Precedent, Covenants and Defaults

Commitment letters for general financings often contain vague and partial lists of documents and conditions that the lenders will require before funding the loans. Phrases like "customary conditions precedent" are often seen. In contrast, a commitment letter for an acquisition financing typically has an explicit, detailed and often lengthy list of conditions.

If the lenders are permitted to require satisfaction of conditions precedent to funding that are not expressly set forth in the signed commitment letter (whether customary conditions or not), this increases the risk to the borrower that these additional conditions cannot be met. It is common in an acquisition financing to see an express statement from the lenders that the list of conditions precedent in the commitment letter are the only conditions that will be required for funding. In some cases the list of conditions precedent in commitment letters for acquisition finance are so detailed that they are copied directly into the final forms of loan agreements.

Similarly, vague references to "customary covenants" and "customary events of default" in a commitment letter present similar risks, particularly proposed inclusion of unreasonable provisions which could not be met by the borrower. To limit this risk, commitment letters for acquisition financings often include fully negotiated covenant and default packages (which may include pages of detailed definitions to be used in calculation of any financial covenants).

Form of Loan Documents

Some sponsors even require that the form of the loan agreement be consistent with "sponsor precedent", meaning that the loan documentation from the sponsor's prior acquisition financing will be used as a model for the new financing. Agreeing to use or be guided by "sponsor precedent" limits the risk to the sponsor that the financing will be delayed or not close because the lender and its counsel produce a draft loan agreement with unexpected terms and provisions.

Many acquisition financings, particularly in the middle market, involve multiple classes of loans with complex intercreditor arrangements. These financings include 1st/2nd lien, split-collateral, *pari passu* collateral, subordinated, holdco and unitranche financings. In complex and technical intercreditor agreements, lenders agree on many issues relating to their respective classes of loans, including priority of liens, priority of debt, control of remedies and certain technical bankruptcy issues. Negotiation of these agreements among different classes of creditors can be lengthy and frustrate closing time frames. As middle market M&A continues to grow, and more deals have complex intercreditor arrangements, some sponsors are also requiring lenders to use a specified form of intercreditor agreement.

Representations and Warranties

Loan agreements typically require that the included representations and warranties be accurate as a condition to funding. Lenders financing the acquisition also want the representations with respect to the target in the acquisition agreement to be accurate. This is reasonable because after consummation of the acquisition, the target is likely to be obligated on the loans (either as the borrower or a guarantor) and thus part of the credit against which the lenders are funding.

"SunGard" (named for an acquisition financing that included these terms) or "certain funds" provisions are now common in commitment letters for acquisition financings. These clauses are relevant to several provisions in a typical commitment letter. With respect to representations and warranties, these clauses provide that on the closing date of the loan, as a condition to the lenders' funding obligations, only certain representations need to be accurate. Strong sponsors even negotiate the precise meaning of the term "accurate". The representations required to be accurate as a condition to the lenders' funding obligation in a typical SunGard clause include the following:

- The only representations and warranties relating to the target are those that, were they untrue, would be material to the lenders and for which the buyer has a right under the acquisition agreement to decline to close the acquisition. While providing certainty of funding, this standard avoids a scenario where the loan agreement has different representations with respect to the target than the acquisition agreement.
- Only certain representations with respect to the borrower set forth in the loan agreement must be accurate (the "specified representations"). These can include those with respect to corporate existence, power and authority to enter into the financing, enforceability of the loan documents, margin regulations, no conflicts with law or other contracts, solvency, status of liens (see below regarding this topic) and certain anti-terrorism and money laundering laws. A financial covenant could also be included as a specified representation in some deals. What are included as specified representations change with changing economic conditions and relative bargaining strength of companies and sponsors. As financial markets have improved and the leverage of sponsors has increased, the typical list of specified representations has shrunk and may well continue to weaken, benefitting sponsors.

These are the only representations applicable as conditions precedent to the initial funding of the loans. Even if the other representations in the loan agreement could not be truthfully made at the time of the initial funding, the lenders nonetheless are contractually obligated to fund the loans.

Company MAC

Company material adverse change (MAC), sometimes referred to as a "company MAC" or a "business MAC", is a type of representation included in some acquisition agreements and loan agreements. This is a representation that no material adverse change in the business of the target has occurred. Inability to make the representations in the acquisition agreement typically permits the buyer to terminate the acquisition agreement and in the loan agreement it excuses the lenders from their funding obligations. A customary MAC definition in an acquisition agreement differs from that in a loan agreement. Acquisition agreement MAC clauses are often more limited in scope and time frame covered, and have more exceptions (including for general market and economic conditions impacting the target). Like other representations, buyers and sellers often require that the MAC definition in loan agreements mirror the definition in acquisition agreements, but solely for purposes of the initial funding of the acquisition loans (and not for ongoing draws under a working capital revolver or a delayed draw term loan, for instance).

Market MAC and Flex

"Market MAC" is another type of MAC representation in some commitment letters. Seen more in economic down-cycles, these clauses allow the lenders to terminate their commitments if there has been a material adverse change in the loan and syndication markets generally. Strong borrowers and sponsors have had success with excluding these clauses in their commitment letters over the last several years as the economy has continued to improve.

As discussed above, the time between signing the commitment letter, on one hand, and closing the acquisition and funding the loans on the other, is often a lengthy period. Lenders whose commitment letters do not have a market MAC, especially those lenders who fully underwrite the commitments, are subject to deteriorating financial markets during the syndication of the commitments and the risk that they will not be able to sell down the commitments to other lenders. "Flex" provisions limit this risk and allow for amendments to certain agreed-upon terms of the financing without the borrower's consent when necessary to allow the lenders arranging the loan to sell down their commitments.

If, during syndication, there is no market for the loans at the price or terms provided in the commitment letter and term sheet, a flex provision will allow the committed lenders to "flex" the pricing terms (by increasing the interest rate, fees or both) within pre-agreed limits or make other pre-agreed changes to the structure of the loans (such as call protections, shorter maturities, etc.). While these changes provide some comfort to committed lenders in gradually deteriorating financial markets, they may not be as helpful in a dramatic downturn where there is little to no market for loans on any terms.

At times of financial and market uncertainty, flex clauses often became broader in scope and gave lenders greater flexibility to change key terms of a financing. The types of provisions that can be subject to flex include interest rate margins, negative covenant baskets, financial covenant ratios, the allocation of credit between first lien, second lien and high yield bonds and the amount and type of fees. As markets improve, sponsors are using their leverage to limit the breadth of flex provisions, and to require greater limits on the scope of the changes that can be made without their consent.

Some sponsors require "reverse flex" arrangements. These provisions require the lenders to amend the financing terms under the commitment letters to be more favourable to the borrower if syndication of the loans is "oversubscribed", meaning that there is more demand from potential lenders than available loans.

Perfection of Liens

As in all secured financings, lenders in an acquisition financing need evidence that their liens on the borrower's assets are perfected and enforceable, preferably as a condition precedent to the initial funding under the loan agreement. However, ensuring perfection of the liens is often highly technical and can be a time-consuming process depending on the nature and location of the borrower's assets and the specific legal requirements for perfection. The technical nature of lien perfection raises the risk (to the borrower and the seller) that lenders will delay or withhold funding for the loans because insufficient steps were taken to perfect the liens, and in an acquisition financing timing and certainty are at a premium.

Typical SunGard provisions limit this risk by requiring delivery at funding of only (i) Uniform Commercial Code financing statements which perfect a security interest in personal property that can be perfected by filing, and (ii) original stock certificates for any pledged shares. Perfecting a security interest in other asset classes is required on a post-funding basis by a covenant detailing what perfection steps are required. The sorts of collateral perfected on a post-closing basis can include real estate, deposit and securities accounts, intellectual property, foreign assets and other more esoteric collateral requiring more complicated efforts.

As financial markets continue to improve, sponsors are likely to continue pushing lenders to increase the time frames to complete post-closing collateral deliverables, give the administrative agent greater flexibility to extend these time frames without lender consent and limit efforts by lenders to increase the collateral deliverables required at closing.

The Acquisition Agreement Matters

Delivery of the executed acquisition agreement is a condition precedent to the lenders' obligation to fund the loans. As discussed in more detail below, as a fallback, lenders sometimes accept a near final draft of the acquisition agreement, coupled with a covenant from the buyer that there will be no material changes. The terms of the acquisition agreement are important to lenders in a number of respects, beyond understanding the structure and business of the borrower after consummation of the acquisition. Lenders also regularly require inclusion of certain provisions in acquisition agreements.

Structure of the Acquisition

The structure of the acquisition is important to the lenders as it will dictate a number of issues for the financing, including collateral perfection, identity of the guarantors and borrowers and timing of the acquisition (*i.e.*, how long the lenders need to have their commitments outstanding). There are a number of common acquisition structures. While the specifics of those structures are beyond the scope of this article, these include stock purchases (with or without a tender offer), mergers (including forward, forward triangular and reverse triangular mergers) and asset purchases. Each has its own unique structuring issues for the lenders.

Representations and Company MAC

As described above, the lenders often rely on the representations and warranties in the acquisition agreement, including the definition of material adverse change, and incorporate those terms into the loan agreement.

Obligation to Continue Operating

Lenders often review whether the seller is contractually obligated in the acquisition agreement to continue operating the business in the ordinary course and not to make material changes to the business. Again, the target is a part of the lenders' credit and the lenders do not want to discover after consummation of the acquisition that the target has been restructured in a way that results in its business being different than the lenders' understanding.

Indemnity

Lenders also typically consider the indemnities provided by the seller in the acquisition agreement. If, after the acquisition is consummated, it is discovered that the seller made a misrepresentation or, worse, committed fraud or other wrongdoing as part of the acquisition, those indemnities could affect the buyer's ability to recover against the seller. If the misrepresentation or wrongdoing results in the lenders foreclosing on the assets of the borrower, the lenders could inherit the indemnities if the rights of the borrower under the acquisition agreement are part of the collateral. Acquisition agreements typically contain anti-assignment and transfer provisions. It is important that those provisions expressly permit the lenders to take a lien on the acquisition agreement.

Purchase Price Adjustments and Earn-Outs

Any payments to be made to the seller by the buyer after consummation of the acquisition are important to the lenders. Many loan agreements define these payments, whether based on performance of the target or other factors, as debt and their payment needs to be specifically permitted by the loan agreement. Beyond technically drafting the loan agreement to permit payment of these amounts, the proceeds to be used to make these payments should be viewed as assets of the buyer that are not available to the lenders to repay the loans and this may impact the credit review of the loan facility.

Xerox Provisions

When a proposed acquisition terminates, the commitment letters for the acquisition financing typically state that the lenders' commitments also terminate. That is not always the end of the lenders' concerns. Many terminated acquisitions result in accusations of breach of contract, wrongdoing or bad faith by the parties. Litigation is not uncommon. Lenders want to make sure that any litigation brought by the seller does not look to the lenders for damages.

Xerox provisions (named for a financing with Xerox where these clauses were first seen) give lenders this protection in the form of an acknowledgment by the seller in the acquisition agreement that the seller's sole remedy against the buyer and its lenders for termination of the acquisition is the breakup fee specified in the acquisition agreement. If the acquisition terminates because the lenders fail to fund their commitments, the lenders may be subject to a breach of contract suit brought by the buyer. But the lenders in any termination scenario often seek to restrict suits brought against them by the seller. Conversely, sellers' focus on certainty of the financing has caused some sellers to push back on inclusion of these provisions. Some sellers with strong leverage even negotiate for the right to enforce remedies (or cause the buyer to enforce remedies) against the lenders under a commitment letter.

Since the lenders are not party to the acquisition agreement, applicable law creates hurdles for the lenders to enforce the Xerox provisions. To address these hurdles, lenders seek to be expressly named as third-party beneficiaries of the Xerox provisions. In the event the lenders have claims against the seller for breach of the Xerox provisions, lenders will have customary concerns about the venue and forum of any claims brought by the lenders under the acquisition agreement. Like in loan agreements, lenders often seek to have New York as the exclusive location for these suits and seek jury trial waivers in the acquisition agreement.

Efforts to Obtain the Financing

Lenders will consider provisions in the acquisition agreement regarding the buyer's obligations to obtain financing. Typically, buyers agree to use "reasonable best efforts" or "commercially reasonable efforts" to obtain the financing in the commitment letter. These provisions may include a requirement to maintain the commitment letter, not to permit any modification to the terms of commitment letter without the seller's consent (with some exceptions), to give notice to the seller upon the occurrence of certain events under the commitment letter, and obtain alternative financing, if necessary. As noted above, acquisition agreements may also contain provisions obligating the buyer to enforce its rights against the lender under the commitment letter, or even pursue litigation against the lender. Buyers with strong leverage will want to limit provisions in the acquisition agreement requiring specific actions against the lenders.

Cooperation with the Financing

As discussed above, the lenders have an interest in understanding the acquisition and the nature of the target's business. Further, the conditions precedent will require deliverables from the target and the lenders' regulatory, credit and legal requirements demand that they receive certain diligence information about the target and its business. None of this can be accomplished if the seller does not agree to assist the buyer and its lenders. Lenders often require that the acquisition agreement include a clause that the seller will cooperate with the lenders' diligence and other requirements relating to the acquisition financing.

Amendments to the Acquisition Agreement

Lenders usually have the opportunity to review the acquisition agreement, or at least a near final version, prior to executing their commitment letters. The buyer and seller will want the lenders to acknowledge that the final agreement or draft is acceptable. The lenders, on the other hand, will want to receive notice of any amendments to the acquisition agreement and ensure they do not adversely impact the financing. To avoid the lenders' refusal to fund the loans because of an amendment to the acquisition agreement, buyers and sellers are often careful to ensure that no amendments to the acquisition agreement will be required. Some amendments are unavoidable and commitment letters often contain express provisions as to the nature of those amendments that need lender approval. If lender approval is not needed, then the lenders cannot use the amendment as a reason to refuse funding.

Negotiations of the "no-amendment" condition focus on the materiality of the amendments and whether the change has to be adverse or materially adverse, with some lenders negotiating consent rights for any material change in the acquisition agreement. Lenders often seek to negotiate express provisions that would be deemed material or adverse, including some of the above clauses that were included in the acquisition agreement at the requirement of the lenders. Some lenders with strong negotiating leverage even negotiate for a clause in the acquisition agreement that any amendments will require the lenders' consent.

Conclusion

Leveraged acquisitions in the United States raise unique structuring issues and techniques, only some of which are discussed here. Expect 2019 M&A volumes to remain high, with sponsors exercising greater leverage over their lenders to further loosen acquisition-lending terms.

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A Comparative Overview of Transatlantic Intercreditor Agreements

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Introduction

The intercreditor frameworks applicable to a given financing structure in a particular market are often fairly settled, but in cross-border financings for European borrowers or other financings involving practitioners and business people in different parts of the world, deal parties may have different expectations as to the key intercreditor terms that ought to apply.

In this article, we will compare and contrast the key terms in U.S. second lien and European second lien intercreditors and discuss the blended approach taken in some recent intercreditor agreements for financings of European companies in the U.S. syndicated bank loan markets. Similar dynamics may be involved when documenting intercreditor agreements involving other non-U.S. jurisdictions as well, but for ease of reference, we will refer to these intercreditor agreements as "Transatlantic Intercreditor Agreements".

Assumptions

U.S. second lien intercreditors are predicated on two key assumptions: *first*, that the business will be reorganised pursuant to Chapter 11 of the United States Bankruptcy Code (Chapter 11); and *second*, that the first lien lenders will receive the benefits of a comprehensive guarantee and collateral package (including shares, cash, receivables and tangible assets) pursuant to secured transactions laws that effectively provide creditors with the ability to take a security interest in "all assets" of the borrower and guarantors. European second lien intercreditors, in contrast, (i) assume that it is unlikely that the borrower and guarantors will be reorganised in an orderly court-approved process and indeed more likely that, since there is no pan-European insolvency regime (and thus no pan-European automatic stay on enforcement of claims), the intercreditor terms will have to function in the context of potentially multiple and disparate insolvency proceedings (ideally outside of insolvency proceedings altogether), and (ii) contemplate that not all assets of the borrower and guarantors will be subject to the liens of the first lien and second lien secured parties. As a result, one of the key goals that European second lien intercreditors seek to facilitate is a swift out-of-court, out-of-bankruptcy, enforcement sale (or "pre-pack") resulting in a financial restructuring where the business is sold as a going concern on a "debt free basis", with "out of the money" junior creditors' claims being released and so removed from the financing structure.

Overview

The first lien/second lien relationship in the U.S. closely resembles the senior/second lien relationship in Europe; however, for the reasons stated above, the key terms of U.S. second lien and European second lien intercreditors have been constructed on the basis of different assumptions, which therefore results in significant intercreditor differences.

European second lien intercreditor agreements typically combine claim subordination, payment blockages, lien subordination, broad enforcement standstill provisions restricting the junior lien creditors' ability to take enforcement action (not only with respect to collateral but also with respect to debt and guarantee claims) and extensive release mechanics. U.S. second lien intercreditors establish lien subordination, which regulates the rights of the U.S. second lien creditors with respect to collateral only, and include an enforcement standstill with respect to actions against collateral only. U.S. second lien intercreditors do not generally include payment or claim subordination and they rely heavily on waivers of the junior lien creditors' rights as secured creditors under Chapter 11.

European second lien intercreditors are often based on the Loan Market Association's form (the "LMA"), but are negotiated on a deal-by-deal basis. By contrast, there is no market standard first lien/second lien intercreditor agreement in the U.S. As discussed below, recent intercreditors for financings of European companies in the U.S. syndicated bank loan markets vary even more significantly, but common themes are emerging.

Key Terms of U.S. Second Lien Intercreditor Agreements and European Second Lien Intercreditor Agreements

1. Parties to the Intercreditor Agreement

U.S. second lien intercreditors are generally executed by the first lien agent and the second lien agent and executed or acknowledged by the borrower and, sometimes, the guarantors. Depending on the flexibility negotiated by the borrower in the first lien credit agreement and second lien credit agreement, the intercreditor agreement may also allow for other future classes of first lien and second lien debt permitted by the credit agreements to accede to the intercreditor agreement. U.S. second lien intercreditors also typically allow for refinancings of the first lien and second lien debt.

By contrast, the parties to European second lien intercreditors generally include a longer list of signatories. In addition to the first lien agent and lenders, the second lien agent and lenders and the obligors, the obligors' hedge providers, ancillary facility lenders, the lenders of intra-group loans, the lenders of shareholder loans and the security agent will execute a European-style intercreditor agreement.

The longer list of parties to European second lien intercreditors is largely driven by the senior creditors' need to ensure that, after giving effect to the senior lenders' enforcement, the borrower group is free and clear of all claims (both secured and unsecured) against the borrower and guarantors coupled with a desire to ensure that any enforcement action by creditors is choreographed in a manner which maximises recoveries for the senior secured creditors (and thus indirectly for all creditors). It has become fairly common for refinancing and incremental debt to be permitted in European deals. European intercreditors typically require such debt to be subject to the intercreditor agreement even if (above a certain threshold amount and subject to negotiation) it is unsecured.

Hedge obligations are generally included as first lien obligations (and sometimes also as second lien obligations) under U.S. second lien intercreditors, but hedge counterparties are not directly party to U.S. second lien intercreditors. By accepting the benefits of the first priority lien of the first lien agent, the hedge counterparties receive the benefits of the first priority lien granted to the first lien agent on behalf of all first lien secured parties (including the hedge counterparties) and the hedge counterparties are deemed to agree that the first lien security interests are regulated by the intercreditor agreement and other loan documents. The hedge counterparties under U.S. second lien intercreditors in syndicated bank financings generally have neither the ability to direct enforcement actions nor the right to vote their outstanding claims (including any votes in respect of enforcement decisions).

Cash management obligations (e.g., treasury, depository, overdraft, credit or debit card, electronic funds transfer and other cash management arrangements) are often included as first lien obligations under U.S. second lien intercreditors on terms similar to the terms relating to the hedge obligations. By contrast, European second lien intercreditors typically do not expressly contemplate cash management obligations. In European financings, the cash management providers would typically provide the cash management services through ancillary facilities – bilateral facilities provided by a lender in place of all or part of that lender's unutilised revolving facility commitment. Ancillary facilities are not a traditional feature of U.S. credit facilities, although increasingly common. The providers of ancillary facilities would be direct signatories of a European second lien intercreditor.

2. Enforcement

a. *Enforcement Instructions*

The first lien agent under a U.S. second lien intercreditor takes instructions from the lenders holding a majority of the loans and unfunded commitments under the first lien credit agreement, which follows the standard formulation of required lenders in U.S. first lien credit agreements. (Note, however, that the vote required to confirm a plan of reorganisation in a Chapter 11 proceeding is a higher threshold – at least two thirds in amount and more than one half in number of the claims actually voting on the plan.)

The security agent under European second lien intercreditors, however, takes instructions from creditors holding 66⅔% of the sum of (i) the drawn and undrawn amounts under the senior credit agreement, and (ii) any actual outstanding liabilities (plus any mark to market value if the senior credit agreement has been discharged) under any hedging arrangements.

b. *Enforcement Standstill Periods*

U.S. second lien financings involve lien subordination as opposed to payment (also referred to as debt or claim) and lien subordination. The result of lien subordination is that only the proceeds of shared collateral subject to the liens for the benefit of both the first lien secured parties and second lien secured parties are applied to repayment in full of the first lien obligations before the second lien secured parties are entitled to receive any distribution of the proceeds of the shared collateral, but the second lien secured parties may receive other payments (such as payments of principal and interest and payments from other sources, e.g., unencumbered property) prior to the first lien obligations being paid in full. In the context of U.S. obligors, it is unlikely, in practice, that there would be substantial property that is unencumbered since the security granted would likely pick up substantially all assets – in contrast to a number of European obligors whose unencumbered assets may be significant due to local law limitations.

Payment subordination requires the junior lien creditors to turnover to the first lien secured parties all proceeds of enforcement received from any source (including the proceeds of any unencumbered property) until the first lien obligations are paid in full. In consequence, the difference in recoveries between lien subordination and payment subordination could be significant in a financing where material assets are left unencumbered, as is likely in a financing in which much of the credit support is outside the U.S.

U.S. second lien intercreditors prohibit the second lien agent from exercising any of its rights or remedies with respect to the shared collateral until expiration of the period ending 90 to 180 days after notice delivered by the second lien agent to the first lien agent after a second lien event of default or, in some cases, if earlier, second lien acceleration. The standstill period becomes permanent to the extent the first lien agent is diligently pursuing in good faith an enforcement action against a material portion of the shared collateral. An exercise of collateral remedies generally includes any action (including commencing legal proceedings) to foreclose on the second lien agent's lien in any shared collateral, to take possession of or sell any shared collateral or to exercise any right of set-off with respect to any shared collateral, but the acceleration of credit facility obligations is generally not an exercise of collateral remedies.

European second lien intercreditors typically contain a much broader enforcement standstill provision than U.S. second lien intercreditors, principally because there is no pan-European equivalent of the Chapter 11 stay. The scope of the restricted enforcement actions typically prohibits any acceleration of the second lien debt, any enforcement of payment of, or action to collect, the second lien debt, and any commencement or joining in with others to commence any insolvency proceeding, any commencement by the second lien agent or second lien creditors of any judicial enforcement of any of the rights and remedies under the second lien documents or applicable law, whether as a secured or an unsecured creditor. The enforcement standstill period has traditionally run for (i) a period of 90 days (in most cases) following notice of payment default under the senior credit agreement, (ii) a period of 120 days (in most cases) following notice of financial covenant default under the senior credit agreement, and (iii) a period of 150 days (in most cases) following notice of any other event of default under the senior credit agreement, plus (in some cases) 120 days if the security agent is taking enforcement action. However, the enforcement standstill period is now often subject to negotiation. In European second lien intercreditors, the senior creditors firmly control enforcement. In addition, the senior agent is entitled to override the junior agent's instructions to the security agent, leaving the second lien lenders only able to influence the timing of enforcement action after the standstill period.

Because the enforcement standstill in U.S. second lien intercreditors is limited to enforcement against shared collateral, U.S. second lien lenders, unlike their European counterparts, retain the right (subject to the Chapter 11 stay) to accelerate their second lien loans and to demand payment from the borrower and guarantors during the standstill period. However, in the event any second lien agent or any other second lien creditor becomes a judgment lien creditor in respect of the shared collateral as a result of enforcement of its rights as an unsecured creditor (such as the ability to sue for payment), the judgment lien would typically be subordinated to the liens securing the first lien obligations on the same basis as the other liens securing the second lien obligations under the U.S. second lien intercreditor agreement. This judgment lien provision effectively limits the effectiveness of the junior lien creditors' efforts to sue for payment, since the junior lien creditors ultimately will not be able to enforce against shared collateral, although the junior lien creditors could still precipitate a bankruptcy filing and/or obtain rights against any previously unencumbered assets of the borrower and guarantors.

3. *Payment Blockages*

U.S. second lien intercreditors do not generally subordinate the junior lien obligations in right of payment to the first lien obligations.

European second lien intercreditors do subordinate the junior lien obligations in right of payment to the senior lien obligations and include a payment blockage period that is typically co-extensive with a payment default under the senior credit agreement and of a duration of 150 days during each year whilst certain other material events of default under the senior credit agreement are continuing. The second lien creditors may negotiate for exceptions to the payment blockage periods, e.g., payment of a pre-agreed amount of expenses related to the restructuring or a valuation of the borrower group (other than expenses related to disputing any aspect of a distressed disposal or sale of liabilities). In addition, separate payment blockage rules typically apply to hedge obligations, shareholder loan obligations and intragroup liabilities in European second lien intercreditors.

4. *Releases of Collateral and Guarantees*

In order to ensure that the junior lien creditors are unable to interfere with a sale of the shared collateral, both U.S. second lien intercreditors and European second lien intercreditors contain release provisions whereby the junior lenders agree that their lien on any shared collateral is automatically released if the first lien creditors release their lien in connection with a disposition permitted under both the first lien credit agreement and the second lien credit agreement and, more importantly, in connection with enforcement by the first lien creditors.

While important in U.S. second lien intercreditors, the release provisions are arguably the most important provision of European second lien intercreditors. Under European intercreditor agreements, in connection with enforcement by the senior creditors (or a "distressed disposal"), the junior security and debt and guarantee claims can be released (or disposed of) subject to negotiated conditions. Market practice continues to evolve, but fair sale provisions are increasingly common, i.e., public auction/sale process or independent fair value opinion. The LMA intercreditor agreement requires the security agent to take reasonable care to obtain a fair market price/value and permits the sale of group entities and release of debt and guarantee claims, and, in addition, the sale of second lien debt claims. European intercreditor agreements typically provide that the security agent's duties will be discharged when (although this list is not exhaustive): (i) the sale is made under the direction/control of an insolvency officer; (ii) the sale is made pursuant to an auction/competitive sales process (which does not exclude second lien creditors from participating unless adverse to the sales process); (iii) the sale is made as part of a court supervised/approved process; or (iv) a "fairness opinion" has been obtained. Any additional parameters/conditions to the above will be negotiated, particularly in deals where specialist second lien funds are anchoring the second lien facility. Typical points for discussion will be: (i) the circumstances in which/whether the senior creditors are entitled to instruct a sale in reliance on a fair sale opinion rather than a public auction; (ii) terms of any public auction (i.e. how conducted, on whose advice, who can participate, who can credit bid); (iii) any requirement for cash consideration; and (iv) any information/consultation rights.

In addition to the release provisions, European second lien intercreditors typically allow (subject to the fair sale provisions discussed above) the security agent to transfer the junior lien debt, intragroup liabilities and/or shareholder loans to the purchasers of the assets in an enforcement situation. The disposal of liabilities option could be more tax efficient than cancelling the subordinated debt in connection with enforcement.

Many of these conditions with respect to sales of collateral are absent in U.S. second lien intercreditors because meaningful protections are afforded by the Uniform Commercial Code requirement for a sale of collateral to be made in a commercially reasonable manner and, in the case of a 363 sale process, by a court-approved sale in Chapter 11, as discussed more fully below.

In addition, the release provisions in U.S. second lien intercreditors are also premised on the first lien and second lien security interests being separately held by the first lien collateral agent and the second lien collateral agent and documented in separate, but substantially similar, documents that are meant to cover identical pools of collateral. In European second lien intercreditors, the release provisions assume that one set of security interests are held by one security agent on behalf of all of the creditors (senior and second lien).

5. *Limitation on First Lien Obligations*

U.S. second lien financings typically include a "first lien debt cap" to limit the amount of first lien obligations that will be senior to the second lien obligations. The analogous provision in European second lien intercreditors is referred to as "senior headroom". Amounts that exceed the first lien debt cap or senior headroom will not benefit from the lien priority provisions in the intercreditor agreement. The "cushion" under the first lien debt cap or senior headroom is meant to allow for additional cash needs of the borrower group, whether as part of a loan workout or otherwise.

The first lien debt cap in U.S. second lien financings is typically 110% to 120% of the principal amount of the loans and commitments under the first lien facilities on the closing date plus 100% to 120% of the principal amount of any incremental facilities (or equivalent) permitted under the first lien credit agreement on the closing date. The first lien debt cap is sometimes reduced by the amounts of certain reductions to the first lien commitments and funded loans (other than refinancings), e.g. mandatory prepayments. The first lien debt cap does not apply to hedging obligations and cash management obligations, which are generally included as first lien priority obligations without limitation (although the amounts are regulated by the covenants in the credit agreements). In addition, interest, fees, expenses, premiums and other amounts related to the principal amount of the first lien obligations permitted by the first lien debt cap are first lien priority obligations, but are generally not limited by the cap itself. The trend in U.S. second lien financings is to allow for larger first lien debt caps; some borrower-friendly U.S. second lien financings even allow for unlimited first lien obligations (subject of course to any covenants restricting debt in the applicable credit agreements and other debt documents, including the second lien credit agreement). Additional capacity is often also permitted in the case of DIP financings in the U.S. (as discussed below).

Senior headroom is typically set at 110% of senior term debt plus revolving commitments in European second lien intercreditors, although the headroom concept is of limited relevance where (as is now common on top-tier sponsor deals) it has not been extended to cover incremental and other additional senior debt. Ancillary facilities that would be provided in European deals *in lieu* of external cash management arrangements would be naturally limited by the amount of the revolving commitments since they are made available by revolving credit facility lenders in place of their revolving commitments. Hedging obligations are typically unlimited but naturally constrained to a degree by the fact that most credit agreements will restrict the borrower group from doing speculative trades.

6. *Amendment Restrictions*

In both U.S. second lien intercreditors and European second lien intercreditors, first lien lenders and second lien lenders typically specify the extent to which certain terms of the first lien credit agreement and the second lien credit agreement may not be amended without the consent of the holder of the other lien. Amendment restrictions are negotiated on a deal-by-deal basis and may include limitations on increasing pricing and limitations on modifications of maturity date and the introduction of additional events of default and covenants. The trend in U.S. second lien intercreditors, in particular in financings of borrowers owned by private equity sponsors, is for few (or no) amendment restrictions. European second lien intercreditors now tend to follow this U.S. approach.

7. *Purchase Options*

Both U.S. second lien intercreditors and European second lien intercreditors contain similar provisions whereby the second lien creditors are granted the right to purchase the first lien obligations in full at par, plus accrued interest, unpaid fees, expenses and other amounts owing to the first lien lenders at the time of the purchase. This purchase option gives the second lien creditors a viable alternative to sitting aside during an enforcement action controlled by the first lien creditors by allowing them to purchase the first lien claims in full and thereby acquire the ability to control the enforcement proceedings themselves.

The European version of the purchase option is similar but also includes a requirement to buy out the hedging obligations, which may or may not be included in U.S. second lien intercreditors.

The triggering events for the purchase option in U.S. intercreditors vary. They generally include acceleration of the first lien obligations in accordance with the first lien credit agreement and the commencement of an insolvency proceeding. Other potential trigger events include any payment default under the first lien credit agreement that remains uncured and unwaived for a period of time and a release of liens in connection with enforcement on shared collateral. The triggering event for the European version of the purchase option also varies and may include acceleration/enforcement by the senior creditors, the imposition of a standstill period on second lien enforcement action or the imposition of a payment block.

8. *Common U.S. Bankruptcy Waivers*

First lien secured parties in the U.S. try to ensure that the first lien secured parties control the course of the Chapter 11 proceeding to the maximum extent possible by seeking advanced waivers from the second lien secured parties of their bankruptcy rights as secured creditors (and, in some cases, as unsecured creditors) that effectively render the second lien secured parties "silent seconds". These waivers can be highly negotiated. However, U.S. second lien intercreditors routinely contain waivers from the second lien secured parties of rights to object during the course of a Chapter 11 proceeding to a debtor-in-possession facility (or "DIP facility"), a sale by the debtor of its assets free of liens and liabilities outside of the ordinary course of business during Chapter 11 proceedings, with the approval of the bankruptcy court (a section 363 sale) and relief from the automatic stay. (The automatic stay stops substantially all acts and proceedings against the debtor and its property immediately upon filing of the bankruptcy petition.)

The enforceability of the non-subordination-related provisions in U.S. second lien intercreditors is uncertain because there is conflicting case law in this area. However, garden-variety subordination-related provisions are regularly enforced by U.S. bankruptcy courts to the same extent that they are enforceable under applicable non-bankruptcy law pursuant to Section 510(a) of the Bankruptcy Code.

The second lien creditors in U.S. second lien intercreditors provide their advanced consent to DIP facilities by agreeing that, subject to certain conditions (including a monetary limit), they will not object to the borrower or any other obligor obtaining financing (including on a priming basis) after the commencement of a Chapter 11 process, whether from the first lien creditors or any other third party financing source, if the first lien agent desires to permit such financing (or to permit the use of cash collateral on which the first lien agent or any other creditor of the borrower or any other obligor has a lien).

In the U.S., second lien claimholders often expressly reserve the right to exercise rights and remedies as unsecured creditors against any borrower or guarantor in accordance with the terms of the second lien credit documents and applicable law, except as would otherwise be in contravention of, or inconsistent with, the express terms of the intercreditor agreement. This type of provision, for the reasons articulated above, does not have a counterpart in and would be inconsistent with the underlying rationale of European second lien intercreditors.

9. *Non-cash Consideration/Credit Bidding*

The LMA intercreditor agreement includes explicit provisions dealing with application of non-cash consideration (including "credit bidding") during the enforcement of security. Credit bidding facilitates debt-for-equity exchanges by allowing the security agent, at the instruction of the senior creditors, to distribute equity to senior creditors as payment of the senior debt or to consummate a pre-pack where the senior debt is rolled into a newco vehicle.

In the U.S., the term "credit bidding" refers to the right of a secured creditor to offset, or bid, its secured allowed claim against the purchase price in a sale of its collateral under section 363(k) of the Bankruptcy Code, thereby allowing the secured creditor to acquire the assets that are subject to its lien in exchange for a full or partial cancellation of the debt. In U.S. second lien intercreditors, the second lien creditors consent to a sale or other disposition of any shared collateral free and clear of their liens or other claims under section 363 of the Bankruptcy Code if the first lien creditors have consented to the sale or disposition. However, the second lien creditors often also expressly retain the ability to credit bid their second lien debt for the assets of the borrower and guarantors so long as the first lien obligations are paid in full in cash. In European intercreditor agreements, the second lien creditors would not typically have an explicit right to credit bid their second lien debt.

10. *The Holders of Shareholder Obligations and Intragroup Obligations*

In addition to direct equity contributions, shareholder loans are often used in European capital structures. Shareholder loans are less common in U.S. capital structures and, if present in the capital structure, would likely be subordinated to the credit agreement obligations under a separately documented subordination agreement (i.e., not included as part of the typical U.S. second lien intercreditor agreement). Similarly, holders of intragroup liabilities would also not be included in U.S. second lien intercreditor agreements. The treatment of intragroup liabilities is often negotiated by the borrower and arrangers in U.S. syndicated credit agreements and, although results differ, the intragroup liabilities are often required to be documented by an intercompany note and made subject to an intercompany subordination agreement. The intercompany subordination agreement would subordinate the intragroup liabilities to be paid by the loan parties to their credit facility obligations and would generally include a payment blockage in relation to intragroup liabilities payable by borrowers and guarantors under the credit facilities during the continuation of an "acceleration event".

Blended Approach Taken in Recent Transatlantic Intercreditor Agreements

Recent intercreditor agreements for financings involving primarily non-U.S. companies in U.S. syndicated bank loan financings, and using NY-law governed loan documents, have taken different approaches to the intercreditor terms, which seem to be determined on a deal-by-deal basis depending on several considerations: (1) the portion of the borrower group's business located in the U.S.; (2) the jurisdiction of organisation of the borrower; (3) the likelihood of the borrower group filing for U.S. bankruptcy protection; and (4) the relative negotiating strength of the junior lien creditors and the borrower, who will be inclined to favour future flexibility and lower upfront legal costs. For these and other reasons, seemingly similar financings have taken very different approaches. Some intercreditor agreements ignore the complexities of restructuring outside of the U.S. and simply use a U.S.-style intercreditor agreement; other similar financings have been documented using the opposite approach – by using a form of intercreditor agreement based on the LMA intercreditor agreement; and still other similar financings have sought to blend the two approaches or to adopt an intercreditor agreement in the alternative by providing for different terms (in particular different release provisions) depending on whether a U.S. or non-U.S. restructuring is to be pursued. Given all of these various considerations, Transatlantic Intercreditor Agreements remain varied. We have highlighted below some of the more interesting points:

- the parties typically have included the holders of intra-group liabilities and shareholder loans, following the European approach, and have embedded restrictions on payment of the intra-group liabilities and shareholder loans under certain circumstances;
- the enforcement instructions are typically required to come from a majority of the first lien loans and unfunded commitments in the U.S.-style while the actual exposures of hedge counterparties (plus mark to market positions post-credit agreement discharge) are taken into account in calculating that majority in the European style;
- the European-style release provisions discussed above generally have been included either as the primary method of release or as an alternative method in the event that a U.S. bankruptcy process is not pursued;
- in certain deals, enforcement standstill and turnover provisions have been extended to cover all enforcement actions and recoveries (broadly defined), rather than just relating to collateral enforcement actions;
- claim subordination of the second lien debt has typically ***not*** been included;
- the full suite of U.S. bankruptcy waivers from the second lien creditors generally have been included; and
- it is sometimes the case, based on the underlying rationale of European intercreditors, that secured or (above an agreed threshold amount) unsecured incremental and refinancing debt (whether *pari passu* or subordinated) is required to be subject to the intercreditor agreement, primarily to ensure it can be released upon an enforcement of this group.

In addition, other provisions appear in Transatlantic Intercreditor Agreements that will not be familiar to those accustomed to the typical U.S. second lien intercreditors, such as parallel debt provisions (a construct necessary in certain non-U.S. jurisdictions in which a security interest cannot be easily granted to a fluctuating group of lenders), expanded agency provisions for the benefit of the security agent and special provisions necessitated by specific local laws to be encountered (or avoided) during the enforcement process (e.g., French *sauvegarde* provisions and compliance with U.S. FATCA regulations).

Conclusion

As the number of financings that touch both sides of the Atlantic continues to rise and the complexity of such financings increases, the intercreditor arrangements for multi-jurisdictional financings will continue to be important and interesting. Whilst there is not a standard or uniform approach to documenting such intercreditor terms, there is now a broad understanding on both sides of the Atlantic in relation to the different provisions and their underlying rationale. Accordingly, most transactions are implemented on a blended basis, combining many of the above-mentioned European or US elements into a US or European intercreditor, respectively. Having said this, as was the case with European second lien intercreditor agreements, a uniform approach is unlikely to emerge until the new forms of Transatlantic Intercreditor Agreement are stress tested in cross-border restructurings.

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Summary of Key Terms of U.S. Second Lien Intercreditor Agreements and European Second Lien Intercreditor Agreements			
Key Terms	**Traditional U.S. Second Lien Approach**	**Traditional European Second Lien Approach**	**Hybrid/Transatlantic Approach**
Parties to the Intercreditor Agreement	The first lien agent and the second lien agent and executed or acknowledged by the obligors.	The first lien agent and lenders, the second lien agent and lenders and the obligors, the obligors' hedge providers, ancillary facility lenders, the lenders of intra-group loans, the lenders of shareholder loans and the security agent.	Generally follows the European approach, except with respect to each lender executing the intercreditor agreement.
Enforcement Instructions	First lien agent takes instructions from lenders holding 50% of the loans and unfunded commitments under the first lien credit agreement.	Security agent takes instructions from creditors holding 66 ⅔% of the sum of (i) amounts under the senior credit agreement, and (ii) any actual exposure under hedging agreements.	Generally follows the U.S. approach, but may include hedge counterparties.
Scope of Enforcement Standstill Provisions	Only applies to enforcement against shared collateral (i.e., lien subordination).	Fulsome enforcement standstill including payment default and acceleration (i.e., payment subordination).	Generally follows the European approach, but depends on negotiation.
Length of Enforcement Standstill Provisions	Typically 180 days but could be from 90 to 180 days depending on negotiation.	Typically (i) 90 days (in most cases) following notice of payment default under the senior credit agreement, (ii) 120 days (in most cases) following notice of financial covenant default under the senior credit agreement, and (iii) 150 days (in most cases) following notice of any other event of default under the senior credit agreement, plus (in some cases) 120 days if the security agent is taking enforcement action.	Generally follows the U.S. approach, but depends on negotiation.
Payment Blockages	None.	Included.	Generally not included.
Releases of Collateral and Guarantees	Releases of collateral included.	Releases of claims included.	Generally follows the European approach.
Limitation on First Lien Obligations	Typically 110% to 120% of the principal amount of the loans and commitments under the first lien facilities on the closing date plus 100% to 120% of the principal amount of any incremental facilities (or equivalent) permitted under the first lien credit agreement on the closing date plus secured hedging and other secured obligations.	Similar to the U.S. approach.	Similar to the U.S. approach.
Amendment Restrictions	May be included depending on negotiation.	Typically included but limited to day-one senior credit agreement.	Generally follows the U.S. approach.
Second Lien Purchase Options (to purchase the First Lien Obligations)	Included.	Included.	Included.
Common U.S. Bankruptcy Waivers	Included.	Not included.	Included.
Non-Cash Consideration/Credit Bidding by First Lien Lenders	Included.	Included.	Included.
Shareholder Obligations	Not included.	Included.	Often included.
Intragroup Obligations	Not included. Often covered by a separate subordination agreement.	Included.	Often included.
Material Unsecured Debt	Not included.	Often included (above a threshold).	Similar.

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- Structured financings.
- Asset-based lending and securitisation.

A Comparison of Key Provisions in U.S. and European Leveraged Loan Agreements

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There are many broad similarities in the general approach taken to European and U.S. leveraged loan transactions, and terms in the documentation of U.S. and European leveraged loans continue to converge with one another (and, in the case of larger leverage transactions, with high-yield bond terms). Notwithstanding a year-end slowdown in the U.S. debt market, the supply of leveraged loans in both markets in 2018 generally continued to lag behind the growing demand of leveraged loan investors, resulting in terms that have become even more borrower-friendly, as deals are consistently oversubscribed. Sponsors and borrowers in both the U.S. and European loan markets have been increasingly successful in pushing the boundaries of once standard lender protections, although the second half of 2018 did lead to successful investor push-back in some areas and with some consistency. Despite these similarities, there are also significant differences in commercial terms and overall market practice in the U.S. and European leveraged loan markets. The importance for practitioners and loan market participants to understand the similarities and differences across the markets has grown in recent years as sophisticated investors now routinely seek to access whichever market may provide greater liquidity and, potentially, more favourable pricing and less risky terms (from the investor's perspective) at any given time.

This chapter will focus on certain of the more significant key differences between practice in the United States and Europe that may be encountered in a typical leveraged loan transaction and is intended to serve as an overview and a primer for practitioners. References throughout this article to "U.S. loan agreements" and "European loan agreements" should be taken to mean New York-law governed and English-law governed leveraged loan agreements, respectively.

Divided into four parts, Part A will focus on differences in documentation and facility types, Part B will focus on various provisions, including covenants and undertakings, Part C will consider differences in syndicate management, and Part D will focus on recent legal and regulatory developments in the European and U.S. markets.

Part A – Documentation and Facility Types

Form Documentation

In both the European and U.S. leveraged loan markets, the form of documentation chosen as a starting point for negotiation and documentation (whether a market form or precedent transaction) will greatly influence the final terms. In Europe, both lenders and borrowers, through conduct adopted over a number of years, expect the starting point to be one of the very comprehensive "recommended forms" published by the LMA (or, to give it its formal title, the Loan Market Association), even if the actual form is a tailored, prior transaction precedent. Conversely, in the United States, although the Loan Syndications and Trading Association (the "LSTA") recently published a form agreement for investment grade transactions, the form on which the loan documentation will be based will be the subject of negotiation at an early stage. Sponsors and borrowers will look to identify a "documentation precedent" – an existing deal on which the loan documentation will be based – and come to an agreement with the arranger banks that the final outcome of negotiations is no less favourable to the borrower than such precedent. In addition, there will be negotiation as to who "holds the pen" for drafting the documentation, as this may also influence the final outcome. Traditionally, the lender side has "held the pen" on documentation, but there is a growing trend, both in the United States and Europe, for the larger sponsor-backed borrowers to insist on taking control of, and responsibility for, producing the key documents which, inevitably, leads to a more borrower-friendly starting point. This trend has further expanded and now often applies to middle-market sponsor-backed borrower deals and larger corporate borrowers.

The LMA (comprised of more than 660 member organisations, including commercial and investment banks, institutional investors, law firms, service providers and rating agencies) has achieved widespread acceptance of its recommended forms as a result of the breadth of its membership and the spread of constituencies represented at the "board" level. Formed initially with the objective of standardising secondary loan trading documentation, the LMA now plays a "senior statesman" advisory role in the European loan market by producing, updating and giving guidance on key provisions in its recommended forms for, amongst other things, investment grade loan transactions, leveraged acquisition finance transactions, developing market and commodity finance transactions, real estate finance transactions and most recently, the growing European private placement market. The LMA plays an active role in monitoring developments in the financial markets, responding to regulatory consultation requests and giving guidance on appropriate approaches in documentation in response to market, regulatory and political developments (indeed, most recently in the context of the outcome of the United Kingdom's referendum to leave the European Union, the update to the EU Blocking Regulation following U.S.-imposed sanctions on Iran, and the decision to phase out LIBOR): its influence and authority is significant.

The widespread use of the LMA standard forms has resulted in good familiarity by the European investor market which, in turn, has added to the efficiency of review and comprehension not just by those negotiating the documents but also by those who may be considering participating in the loan. The LMA recommended forms are only a starting point, however, and whilst typically, the "back-end" LMA recommended language for boilerplate and other non-contentious provisions of the loan agreement will be only lightly negotiated (if at all), the provisions that have more commercial effect on the parties (such as mandatory prepayments, business undertakings, financial covenants, representations and warranties, transfer restrictions, conditions to drawdown, etc.) remain as bespoke to the specific transaction as ever.

Similar to the LMA in Europe, the LSTA in the United States (an organisation of banks, funds, law firms and other financial institutions) was formed to develop standard procedures and practices in the trading market for corporate loans. One of the main practical differences from the LMA, however, is that although the LSTA recently published a form of investment grade credit agreement and has developed some recommended standard documentation for leveraged loan agreements, those forms are rarely used as a starting draft for negotiation, and the form documentation for leveraged loan agreements is largely limited to the mechanical and "miscellaneous" provisions of the loan agreements, such as assignment documentation, EU "bail-in" provisions and tax provisions. Historically, U.S. documentation practice was based on the forms of the lead bank or agent (which may have, in fact, incorporated at least some of the LSTA recommended language), but there has been a shift to identifying a "documentation precedent". In the case of a corporate borrower, this may be the borrower's existing credit agreement or that of another similarly situated borrower in the same industry. A sponsor-backed borrower will likely identify existing documentation for another portfolio company of the sponsor, which puts the onus on the lead bank to identify any provisions that may negatively impact syndication.

In relation to market and regulatory developments that could affect both loan markets as a whole, the LSTA and LMA often cooperate and coordinate their approach in issuing guidance and recommended language.

Facility Types

The basic facility types in both U.S. and European leveraged loan transactions are very similar. Typically, a loan agreement will provide for a term loan facility and/or a revolving credit facility, which are most often secured on a *pari passu* basis. In addition, in the United States (and increasingly in Europe), loan agreements may also provide for uncommitted "incremental facilities", which can take the form of additional term loans or revolving credit commitments. While the borrower will have to satisfy certain customary conditions to obtain these incremental facilities (in addition to obtaining commitments), the consent of existing lenders is not required. Of course, depending on the nature of the borrower's business and objectives, there could be other specific standalone facilities, such as facilities for acquisitions, capital expenditures and letters of credit, but such facilities are beyond the purview of this article.

In the United States and in Europe all lenders (whether revolving credit lenders or term loan lenders) in a first lien or unitranche facility will share the same security package, the same ability to enforce such security and the same priority in relation to payments and the proceeds from the enforcement of security, unless there is a "first in last out" structure, which, as discussed below, is sometimes used in the U.S. Alternatively, a transaction may be effected through a first lien/second lien structure, in which the "first lien" and "second lien" loans are secured by the same collateral but the liens of the second lien lenders are subordinated to those of the first lien lenders (i.e., no collateral proceeds or prepayments may be applied to any second lien obligations until all first lien obligations are repaid). If there is a revolving credit facility, this will be included in the first lien facilities. The second lien facility will be a term loan with no interim amortisation payments. First lien/second lien structures are treated as essentially two separate loans, with two sets of loan documents and two agents, with the relationship between the two lender groups set out and governed under an intercreditor agreement.

In the U.S., however, over recent years, a market trend has developed for certain transactions (typically smaller deals) to instead effect a "first lien/second lien" structure through a unitranche facility, in which there is a single loan with two tranches – a first out tranche and a last out tranche. In such a facility, there is only one set of loan documents, one agent, one set of lenders and, from the borrower's perspective, one interest rate (because the borrower pays a blended rate, and, depending on the market appetite for the different levels of risk, the lenders decide the allocation of interest between the first out lenders and the last out lenders). A separate agreement among lenders ("AAL") governs the rights and obligations of the first out and last out lenders, including voting rights, and also the previously mentioned allocation of interest between the lenders. Alternatively, the allocation of rights and obligations among the lenders may be included in the loan agreement itself, which borrowers may prefer, as it gives them insight into voting rights. Previously there was a question as to whether a court presiding over a borrower's bankruptcy could construe and enforce an AAL in the bankruptcy (even though borrowers are not party to AALs); the *In re RadioShack Corp.* bankruptcy litigation largely resolved this question by implicitly recognising the court's ability to interpret and enforce an AAL.

In Europe, driven by the rising prominence of debt funds and alternative capital providers, unitranche and direct loan facility structures are also playing a much more significant role in the debt market, primarily in the smaller to mid-market transactions, though funds are keen to emphasise their ability to do much larger financings. It is worth noting that debt funds and alternative capital providers may not always have the capacity to provide lines of working capital to prospective borrowers and as such, they may "club" with commercial banks to provide this component of the financing. In such instances, the commercial bank may retain a senior ranking over the debt fund/alternative capital provider.

Similarly to U.S. unitranche structures, European unitranche structures also utilise an AAL, to which typically the borrower will not be party. In a restructuring context, European unitranche structures have also raised their own issues – in particular, questions around whether the first out and last out creditors comprise a single class for the purposes of an English law scheme of arrangement under Part 26 of the Companies Act 2006, notwithstanding the various creditors' distinct economic positions and interests as set out in the AAL. Whilst unitranche structures and the rights of unitranche creditors in a scheme of arrangement have not been directly considered by the courts, recent cases (such as *Re Apcoa Parking Holdings GmbH & Ors*)[1] suggest that unless creditors can demonstrate that their distinct economic rights are also accompanied by corresponding legal rights enforceable against the borrower (which will not typically be the case where the borrower is not party to the AAL), it is likely to be difficult for junior creditors to maintain that they should form a separate class in a scheme of arrangement (and, as such, forfeiting the potential hold-out value that may entail during the course of a borrower's restructuring).

Following a notable increase in the number of European middle market unitranche loan structures backed by private debt funds, many traditional banks have responded by forming partnerships with alternative lenders. These alternative lenders typically offer Payment in Kind ("PIK") loans to compliment the senior bank loan, raising leverage on the overall financing and ensuring the banks are able to remain competitive with the private debt funds. Whilst historically PIK loan instruments have been suited to larger companies with high levels of liquidity, the number of PIK loans extended to the middle market increased during 2018.[2] It is worth noting, however, that the extension of these highly subordinated PIK loans to smaller (often less liquid) companies is still treated with caution by many lenders.

In the case of European borrowers with both high-yield bond debt and bank debt (usually revolving credit facilities) in their capital structures, so called "super senior" structures are also very common. In such structures, both the lenders under the revolving credit facility and the high-yield noteholders rank equally in regards to payment and the security package (where the notes are secured). However, the lenders under the revolving credit facility are "super senior" in that they take priority over the noteholders in relation to the proceeds of recovery from any enforcement action (the exchange for this typically being that the high-yield noteholders have the ability to enforce and direct enforcement first, for a certain period of time).

Term Loan Types

The terms of a financing are influenced not just by the size and nature of the transaction but also by the composition of the lending group. Term A loans are syndicated in the United States to traditional banking institutions, who typically require a five-year maturity, higher amortisation (which may be up to 5% or 10% per year) and tighter covenants characteristic of Term A loans. In leveraged lending, Term A loans will include one or more financial maintenance covenants, typically leverage tests and a fixed charge or interest coverage test, that are tested quarterly. Term B loans, which comprise a large percentage of the more sizeable leveraged loans (especially in the United States), are typically held by investors who also participate in high-yield debt instruments. As a result, Term B loans are more likely to be governed by "covenant-lite" agreements (in which only the revolving credit facility has the benefit of the financial maintenance covenant, and the covenant is only tested if usage exceeds a certain percentage of the revolving credit commitments – typically 25% to 35%) and provide greater overall covenant flexibility. The maturity date of Term B loans will also be longer – six or seven years is typical, and a second lien Term B loan may even have an eight-year maturity. To compensate for these more borrower-friendly terms, Term B loans have a higher interest rate margin and other economic protections (such as "soft-call" and "no-call" periods and "excess cash flow" mandatory prepayment provisions) not commonly seen in Term A loans. The high demand by Term B loan investors, often enticed by the floating-rate component of leveraged loans and their seniority over unsecured bonds, has resulted in an increasing willingness to accept fewer protections in the loan documentation. This trend has caused some concerns regarding the erosion of key covenants, such as restrictions on asset transfers and prohibitions on borrowers selling collateral prior to repayment of their loans, that may significantly affect the probability of recovery rates in default scenarios.[3] However, the trend to increasingly relaxed terms faced some resistance near the end of 2018, when sharp declines in the trading prices of existing leveraged loans, notwithstanding performing credits and low default rates, began to prompt more investor-friendly terms (in the form of higher spreads and tighter covenants)[4] on a limited supply of new issuances of debt in response to a lower risk appetite for investors. In some cases, lenders were able to pressure borrowers to tighten leverage covenants and otherwise "flex up" terms (including pricing). Other deals that were underwritten at the market peak have been postponed as volatility increased during the year-end period.[5] A key question for the beginning of 2019 will be for market participants to determine how long this volatility will continue.

Whilst in the past European sponsors and borrowers unable to negotiate sufficiently flexible or desirable loan terms with their usual relationship banks had to resort to U.S. Term B loans and the U.S. high-yield bond market in order to achieve the flexibility they desired, the growth of debt funds, direct lenders and the enthusiasm of U.S. institutional investors in the European loan market to participate has led to the evolution of the English law "European TLB" market. Indeed, the European TLB market is now an established and attractive funding option for borrowers in larger leveraged transactions with terms frequently as flexible (and sometimes more flexible) than those seen in their U.S. Term B loan equivalent. Many larger borrowers and sponsors in the European TLB market have been very successful in negotiating generous borrower-friendly relaxations in their loan covenants (in particular relating to debt capacity, permitted disposals and acquisitions, and financial covenant cure rights, to the extent the loan is not "covenant-lite"), although most European TLB instruments are still likely to contain guarantor maintenance coverage tests (requiring the accession of additional guarantors and the provision of additional security if the required test thresholds are not met), and to have higher lender consent thresholds.

Certainty of Funds

In the United Kingdom, when financing an acquisition of a UK incorporated public company involving a cash element, the City Code on Takeovers and Mergers requires purchasers to have "certain funds" prior to the public announcement of any bid. The bidder's financial advisor is required to confirm the availability of the funds and, if it does not diligence this appropriately, may be liable to provide the funds itself should the bidder's funding not be forthcoming. Understandably, both the bidder and its financial advisor need to ensure the highest certainty of funding. In practice, this requires the full negotiation and execution of loan documentation and completion of conditions precedent (other than those conditions that are also conditions to the bid itself) at the point of announcement of the public bid.

Whilst not a regulatory requirement, the concept of "certain funds" has also permeated the private buyout market in Europe, so that sponsors are (in practice) required to demonstrate the same level of funding commitment as if they were making a public bid, albeit that this is not a legal or regulatory requirement in a private bid.

In the United States, there is no regulatory certain funds requirement as in the United Kingdom and, typically, only commitment papers, rather than full loan documents, are executed at the time when the bid becomes binding on the bidder (that is, upon execution of a purchase agreement, merger agreement or other acquisition agreement). Despite the absence of a regulatory requirement, the parties will largely agree on terms of the final loan documentation while negotiating the commitment letter (including a definitive list of what representations, warranties, covenants and events of default will be included and the definition of EBITDA, including "add-backs"). Increasingly, commitment letters include more detailed term sheets that set forth specific baskets and thresholds for covenants and events of default and identify leverage levels for the incurrence tests for debt, restricted payments, restricted debt payments and investments. In the United States, commitment papers for an acquisition financing will contain customary "SunGard" provisions that limit the representations and warranties that are required to be accurate, and, in some cases, those that are required to be made by the loan parties, at closing and provide a post-closing period for the delivery of certain types of collateral and related documentation and, in some cases, guarantees. Typically, only Uniform Commercial Code financing statements and stock certificates (and related stock powers) of the borrower and material U.S. restricted subsidiaries are required by the lenders on the closing date of the loan (and, then, only to the extent actually received from the target). Given the level of commitment implicit in New York law commitment papers and the New York law principle of dealing in good faith, there is probably little difference as a practical matter between European "certain funds" and SunGard commitment papers, but it is still most unlikely that SunGard would be acceptable in a City Code bid.

Part B – Loan Documentation Provisions

Covenants and Undertakings

Whilst the dominant theme of recent years has been the increasing European adoption of U.S.-style loan provisions that are more flexible and borrower-friendly – or "convergence" as it is commonly referred to – many differences remain between U.S. and European loan agreements in the treatment and documentation of covenants (as such provisions are termed in U.S. loan agreements) and undertakings (as such provisions are termed in European loan agreements). This Part B explores some of those differences.

Both U.S. and European loan agreements use a broadly similar credit "ring fencing" concept that underpins the construction of their respective covenants/undertakings. In U.S. loan agreements, borrowers and guarantors are known as "loan parties", whilst their European equivalents are known as "obligors". In each case, loan parties/obligors are generally free to deal between themselves as they are all within the same credit group and bound under the terms of the loan agreement. However, to minimise the risk of credit leakage, loan agreements will invariably restrict dealings between loan parties/obligors and other members of the borrower group that are not loan parties/obligors, as well as third parties generally. In U.S. loan agreements, there is usually an ability to designate members of the borrower's group as "unrestricted subsidiaries" so that they are not subject to the covenants of the loan agreement, do not make the representations and warranties in the loan documents, and do not guarantee the borrower's obligations. In exchange for such freedom, the loan agreement will limit dealings between members of the restricted and unrestricted group. In addition, EBITDA attributed to the unrestricted group likely will not be taken into account in calculating financial covenants (unless distributed to a member of the restricted group), and debt of the unrestricted group is similarly excluded. Borrowers are negotiating for more flexibility with respect to unrestricted subsidiaries, but lenders have been pushing back due to recent attempts by borrowers to use these unrestricted subsidiaries to consummate transactions not intended to be permitted. One notable example of such a manoeuvre came in December 2016 when J Crew Group, which owned its domestic trademarks through a restricted subsidiary, transferred a significant interest in those trademarks to a foreign restricted subsidiary, which in turn transferred it to an unrestricted subsidiary and subsequent transfers were made to other unrestricted subsidiaries. In response to the high-profile clash between J Crew Group and its credit agreement investors, there is a limited trend toward including a specific prohibition on transfers of material intellectual property to an unrestricted subsidiary – commonly known as the "J Crew blocker".[6] Whilst not historically a feature of the European loan market, the use of the "restricted/unrestricted" subsidiary construct is now also sometimes seen in European loan agreements, particularly in the context of European TLB instruments.

Restrictions on Indebtedness

Leveraged loan agreements include a covenant, referred to as an "indebtedness covenant" in U.S. loan agreements and a "restriction on financial indebtedness" undertaking in European loan agreements, that prohibits the borrower and its restricted subsidiaries from incurring indebtedness other than certain identified permitted indebtedness. Typically, "indebtedness" of a person will be broadly defined in the loan agreement to include borrowed money and other obligations such as notes, letters of credit, contingent and lease obligations, hedging liabilities (on a mark-to-market basis) and guarantees of obligations otherwise constituting indebtedness, as well as indebtedness of third parties secured by assets of such person.

In U.S. loan agreements, the indebtedness covenant prohibits all indebtedness with baskets allowing for specific types and/or amounts of indebtedness. Some of these exceptions are customary, such as loans to entities within the credit group, non-speculative hedging obligations and capital expenditures (up to an agreed upon cap), but others may be tailored to the business of the borrower. In addition, there are other baskets, such as the general "basket" of debt (which can take the form of a fixed amount or a formula based on a percentage of total assets or EBITDA or a combination, such as the greater of a fixed amount and a percentage formula), an "incurrence-based" basket, which requires compliance with a given leverage or fixed charge ratio, and a basket for indebtedness acquired and/or assumed in connection with permitted acquisitions. These other baskets will be sized based on the borrower's business and, if applicable, the lead bank's relationship with the sponsor or the borrower, as applicable. Reclassification provisions (allowing the borrower to utilise one type of permitted debt exception and then reclassify the incurred permitted debt under another exception) are also becoming more common in the United States. Some U.S. loan agreements contain reclassification provisions applicable to other covenants (such as the lien and investment covenants, and, in more aggressive deals, the restricted payment and restricted debt payment covenants) in addition to indebtedness covenants, permitting borrowers to reclassify transactions that were permitted under a fixed basket as permitted under an unlimited leveraged-based basket after the borrower's financial performance improves. Some agreements allow borrowers to use restricted payment and restricted debt payment capacity to incur debt or make investments. This is part of a more general trend of giving borrowers flexibility to use a basket designated for a specific purpose for other purposes.

The loan agreements of large cap and middle market U.S. borrowers also typically provide for an incremental facility allowing the borrower to incur additional debt under the credit agreement (on top of any commitments the credit agreement originally provided for), or, in *lieu* thereof, additional *pari passu* or subordinated secured or unsecured incremental debt outside the credit agreement under a separate facility (known as "incremental equivalent" provisions). Traditionally, the incremental facilities were limited to a fixed dollar amount, referred to as "free-and-clear" tranches, but now many borrowers can incur an unlimited amount of incremental loans so long as a *pro forma* leverage ratio is met (which will be a first lien secured or total leverage test, depending on whether the new debt is to be secured on a *pari passu* or junior basis or is unsecured). These levels are generally set to require compliance with closing date leverage levels or, in the case of unsecured debt, with a specified interest coverage ratio (typically 2.0×). The use of an interest coverage ratio for debt incurrence borrows from the high-yield bond world. Some deals include increased ratio incremental capacity for acquisitions by providing that the borrower may incur incremental term loans either if the borrower complies with a specified *pro forma* leverage test or if *pro forma* leverage does not increase as a result of the acquisition.

Some borrowers have negotiated the ability to refresh their free-and-clear basket by redesignating debt originally incurred under the free-and-clear basket as debt incurred under the leverage-based incremental capacity. Most U.S. loan agreements permit borrowers to simultaneously use the free-and-clear basket and the leveraged-based incremental basket without the former counting as leverage for purposes of the ratio test. Borrowers have also become more creative with provisions that allow for increases to the free-and-clear basket over the life of the loan, including *pro rata* increases in free-and-clear baskets upon voluntary prepayments of existing loans and/or voluntary reductions in revolving commitments and having the size of the free-and-clear basket increase as the borrower's EBITDA grows.

Most incremental facilities have a most favoured nations clause that provides that, if the margin of the incremental facility is higher than the margin of the original loan, the original loan's margin will be increased to within a specific number of basis points (usually 50 basis points but aggressive sponsors increasingly seek 75 basis points) of the incremental facility's margin. Sponsor-friendly loan agreements often include limitations with respect to most favoured nation clauses, usually a "sunset" restricting its application to a certain timeframe, typically six to 18 months following closing (although the tightening of the U.S. debt market in 2018 saw such "sunset" provisions being flexed out of deals). Such sponsor-friendly agreements often incorporate further provisions aimed at eroding MFN protection, including (i) limiting MFN protection to incremental term loans borrowed using the free-and-clear capacity, refinancing incremental term loans or incremental term loans that mature within a certain period (say, two years) of the latest-maturing existing term loans, and (ii) setting a threshold amount of incremental term loans that may be borrowed without triggering MFN protection. Rather than providing that the MFN provision is limited to incremental loans incurred under the free-and-clear incremental basket, some U.S. deals provide that MFN protection is limited to incremental term loans incurred under the ratio incremental capacity. This allows borrowers to incur incremental debt under the free-and-clear incremental basket and then reclassify such debt as incurred under the ratio incremental capacity, thereby avoiding the MFN provision and refreshing their free-and-clear incremental capacity.

U.S. loan agreements also typically include an exception to the debt covenant for refinancing debt. Historically, refinancing debt was subject to limitations as to principal amount, maturity, weighted average life to maturity, ranking, guarantees and security. The trend of looser terms in U.S. loan agreements is evident in innovative tinkering with the concept of refinancing debt, though. Traditionally borrowers could incur refinancing debt in a principal amount not to exceed the principal amount of the old debt plus accrued interest, fees and costs. It is now common for the cap to also include the amount of any unused commitments. Borrowers can obtain commitments that they cannot immediately use because there is no capacity under any of their debt baskets, so this formulation can result in problems. For example, consider a first lien loan agreement that permits second lien refinancing debt in an amount equal to the old debt plus incremental debt permitted by the second lien loan agreement. The borrower could obtain commitments for second lien refinancing debt exceeding the principal amount of its old second lien debt. Then, the borrower could refinance and fully borrow under all the commitments it obtained, sidestepping its incurrence test and any need for first lien lender consent.

The restriction on financial indebtedness undertaking typically found in European loan agreements is broadly similar to its U.S. covenant counterpart and usually follows the same construct of a general prohibition on all indebtedness, followed by certain "permitted debt" exceptions (both customary ordinary course type exceptions as well as specifically tailored exceptions requested by the borrower). A notable recent trend in the European loan market (particularly in larger leveraged transactions) has been the relaxations around the ability of borrowers to incur additional debt. There is now a definite trend towards U.S.-style permissions, such as "permitted debt" exceptions based on a leverage and/or secured leverage (and sometimes interest coverage) ratio test combined with a general fixed permitted basket where such additional (or incremental) debt may be incurred within the loan agreement by way of an accordion facility, or outside the loan agreement by way of a separate side-car facility (demonstrated in the fact that the LMA now includes incremental facility language in its standard form documentation).

Indeed, uncapped, leverage ratio-based incremental debt capacity is now a standard feature of many recent large-cap European loan agreements, and most such agreements will also provide for a further "freebie" or "free-and-clear" amount. Through the first half of 2018, 90% of European loan agreements featuring incremental debt capacity also provided the borrower with a "freebie" (the use of which was not conditional upon the borrower's ability to meet the relevant incremental debt ratio test). Most of these "freebies" were soft-capped grower baskets, determined by reference to EBITDA (with three quarters of the "freebies" measured at 100% of EBITDA, though many were subsequently reduced to 75% and 50%).[7] As in the case of U.S. loan agreements, European loan agreements with incremental facility provisions will invariably also contain MFN protections. Over the past year, almost all European loan agreements provided MFN protection for existing term lenders. However, half of those provisions included limitations on the MFN protection. A number of European loan agreements excluded from MFN protection any incremental debt incurred in a different currency, or any incremental debt maturing more than 12 months after the original loan. Other loan agreements contained a *de minimis* threshold for incremental debt (beneath which no MFN protection is afforded to the lenders). Sunset provisions have also become the norm in the European loan market, with 12-month and six-month periods present in 41% and 45% of European loan agreements in the first half of 2018 respectively.[8]

Restrictions on Granting Security/Liens

U.S. loan agreements will also invariably restrict the ability of the borrower (and usually, its subsidiaries) to incur liens. A typical U.S. loan agreement will define "lien" broadly to include any charge, pledge, claim, mortgage, hypothecation or otherwise any arrangement to provide a priority or preference on a claim to the borrower's property. This lien covenant prohibits the incurrence of all liens but provides for certain typical exceptions, such as liens securing permitted refinancing indebtedness, purchase money liens, statutory liens and other liens that arise in the ordinary course of business, as well as a general basket based on a fixed dollar amount or a percentage of consolidated total assets or EBITDA to secure a specified amount of permitted indebtedness. In some large cap deals, both in the U.S. and in Europe, borrowers are able to secure permitted indebtedness based on a first lien leverage ratio or senior secured leverage ratio. The provisions that permit such indebtedness typically will provide that the additional indebtedness may be secured on a *pari passu* basis, subject to a prohibition on earlier maturity and a most favoured nations clause in order to prevent a borrower from incurring priming or dilutive debt.

The European equivalent, known as a "negative pledge", broadly covers the same elements as the U.S. restriction on liens (with the same business driven exceptions), but typically goes further and restricts "quasi-security" where the arrangement or transaction is entered into primarily to raise financial indebtedness or to finance the acquisition of an asset. "Quasi-security" includes transactions such as sale and leaseback, retention of title and certain set-off arrangements.

Restriction on Investments

A restriction on the borrower's ability to make investments is commonly found in U.S. loan agreements. "Investments" include loans, advances, equity purchases and other asset acquisitions. Historically, investments by loan parties in non-loan parties have been capped at modest amounts. In some large cap deals, however, loan parties have been permitted to invest uncapped amounts in any of their restricted subsidiaries, including foreign subsidiaries who are not guarantors under the loan documents. Other generally permitted investments include short-term securities or other low-risk liquid investments, loans to employees and subsidiaries, and investments in other assets which may be useful to the borrower's business. In addition to the specific list of exceptions, U.S. loan agreements also include a general basket, sometimes in a fixed amount, but increasingly based on a flexible "builder basket" growth concept.

The "builder basket" concept, typically defined as a "Cumulative Credit" or an "Available Amount", represents an amount the borrower can utilise for investments, restricted payments (as discussed below), debt prepayments or other purposes. Traditionally, the builder basket begins with a fixed-dollar amount and "builds" as retained excess cash flow (or in some agreements, 50% of consolidated net income) accumulates. Some loan agreements may require a borrower to meet a *pro forma* financial test to use the builder basket for restricted payments or debt prepayments. The use of 50% of consolidated net income rather than retained excess cash flow as the "builder" component of the basket is an example of convergence with high-yield bond indentures. This approach gives borrowers more flexibility because a basket using consolidated net income is usually larger – borrowers seek to have excess cash flow to be zero to eliminate any mandatory prepayment, but that also results in zero retained excess cash flow.

Investment covenant exceptions in U.S. deals are becoming increasingly permissive. Deals sometimes include unlimited ability to invest in and acquire non-guarantor restricted subsidiaries or provide that capacity for investments in non-loan parties can be redesignated to the general basket, increasing general investment capacity. Another new creative investment covenant change is to provide that all restricted payment and restricted debt payment capacity may be used for investments. This has its roots in the high-yield bond market where investments are treated as a type of restricted payment.

One area where there has been noticeable loosening of investment capacity is with respect to investments in unrestricted subsidiaries. It is becoming more common to be able to use an increasing number of investment baskets for investments in unrestricted subsidiaries, including the general basket, the available amount basket, the ratio basket and the similar business basket. Some agreements further allow non-guarantor restricted subsidiaries to use any proceeds they receive from investments under other investment baskets to invest in unrestricted subsidiaries, converting all other investment baskets into unrestricted subsidiary investment capacity. All this increasing investment capacity, particularly regarding investments in unrestricted subsidiaries, can be problematic for the lenders to a borrower in need of cash because it allows the borrower to use its large amount of investment capacity to invest in an unrestricted subsidiary and then have that subsidiary borrow additional secured debt. Excessive investment capacity in unrestricted subsidiaries can also be used to increase the available amount restricted payment capacity upon the sale or redesignation of any investments in unrestricted subsidiaries. As discussed earlier in this Part B, some lenders are including a specific prohibition on transfers of material intellectual property to an unrestricted subsidiary.

European loan agreements will typically contain stand-alone undertakings restricting the making of loans, acquisitions, joint ventures and other investment activity by the borrower (and other obligors) and commonly restricted such activity by way of fixed cap baskets and other additional conditions. The prevalence of builder baskets in European loan agreements continues to increase, and whilst they remain less common than in U.S. loan agreements, often acquisitions will be permitted if funded from certain sources, such as retained excess cash flow.

Whilst (historically) reference to ratio tests alone were not commonly seen in European loan agreements, it is now common for borrowers to be permitted to make acquisitions subject to satisfying a *pro forma* leverage ratio test (with fewer additional conditions on acquisitions generally). For stronger borrowers, it is becoming standard for there to be no restrictions on their ability to acquire entities that will become wholly-owned subsidiaries (as opposed to acquisitions of interests in joint ventures and other investments). Soft-capped baskets for acquisitions and investments (where the monetary limit is based on the greater of a fixed amount and a percentage of earnings or asset value, and increasingly, fixed at a percentage of EBITDA) are also now more commonplace in the European market.

Restricted Payments

U.S. loan agreements will typically restrict borrowers from making payments on equity, including repurchases of equity, payments of dividends and other distributions, as well as payments on subordinated debt. As with the covenants outlined above, there are typical exceptions for restricted payments, such as payments on equity solely in shares of stock, or payments of the borrower's share of taxes paid by a parent entity of a consolidated group. Similar to the trend toward broadening investment capacity, U.S. deals are incorporating increasingly permissive restricted payment baskets. For example, it is becoming more common to allow loan parties to make a dividend consisting of equity in unrestricted subsidiaries. Such a basket, together with the increasingly borrower-friendly investment covenant baskets described above which permit larger investments in unrestricted subsidiaries, give borrowers greater flexibility to move assets outside the credit group, such as by contributing assets to an unrestricted subsidiary using their broad investment capacity and then dividending the unrestricted subsidiary to the borrower's shareholders. Under the terms of agreements with these provisions, lenders would have no consent rights over such a transaction and no ability to exercise remedies as a result, even though the collateral package was negatively affected. Another trend is the removal of event of default conditions on the use of baskets such as the available amount basket and the ratio restricted payment basket or the limiting of an event of default condition to only payment defaults and bankruptcy defaults. A recent innovation seen in at least one U.S. deal would permit the borrower to offer to make voluntary prepayments of term loans on a *pari passu* basis at any time, and any declined proceeds could be used to make restricted payments.[9]

In European loan agreements, such payments are typically restricted under separate specific undertakings relating to dividends and share redemptions or the making of certain types of payments to non-obligor shareholders, such as management and advisory fees, or the repayment of certain types of subordinated debt. As usual, borrowers will be able to negotiate specific carve-outs (usually hard capped amounts) for particular "permitted payments" or "permitted distributions" as required (for example, to permit certain advisory and other payments to the sponsor), in addition to the customary ordinary course exceptions.

In U.S. loan agreements, a borrower may use its "builder basket" or "Available Amount" (increasingly based on consolidated net income rather than retained excess cash flow as discussed above) for restricted payments, investments and prepayments of debt, which may be subject to compliance with a certain financial ratio test (typically closing date leverage for investments, half a turn inside closing date leverage for restricted payments and a quarter turn inside closing date leverage for junior debt prepayment).

European loan agreements typically have not provided this broad flexibility, although this is changing in the context of large-cap deals and the increasing role of the European TLB market. Whilst strong sponsors and borrowers have typically been able to negotiate provisions permitting payments or distributions from retained excess cash flow, subject to satisfying a certain leverage ratio, deal trends over the last 18 months have revealed that the U.S. approach towards allowing restricted payments is now being accepted in Europe. "Builder baskets" analogous to those in U.S. loan agreements were present in nearly two thirds of European senior secured leveraged loans through the first half of 2018 (up 15% on 2017). Of these, 80% contained "builder baskets" calculated upon 50% consolidated net income (with the remainder based on retained excess cash flow). This trend, in addition to the prevalence of loan agreements containing an uncapped upstream payment ability (albeit subject to satisfaction of a *pro forma* leverage test), further illustrates the convergence of terms between the U.S. and European markets.

Call Protection

In both European and U.S. loan agreements, borrowers are commonly permitted to voluntarily prepay loans in whole or in part at any time. However, some U.S. loan agreements do include call protection for lenders, requiring the borrower to pay a premium if loans are repaid within a certain period of time (the "call period"). Whilst "hard call" premiums (where term loan lenders receive the premium in the call period for any prepayment, regardless of the source of funds or other circumstances) are rare in the first lien Term B loan market, "soft call" premiums (also known as "repricing protection" and typically 1% of the amount repriced) on prepayments made within a certain period (typically six months to a year after closing, although 18 months has been becoming more common)[10] and funded from a refinancing or re-pricing of loans at a lower rate are common in the U.S. loan market. In some large cap deals, though, there are exceptions to call protection premiums in connection with a refinancing in connection with any transaction that would constitute an initial public offering, a change of control or a transformative acquisition. Some deals include no call protection at all.

Whilst call protection is relatively rare in the European market for senior (bank held, term loan A) debt, soft call protections (usually 1% in the first six-month call protection) are now common in European loans that have been structured to be sold or syndicated to institutional investors (for example, TLBs). Hard call protection provisions are more commonly seen in the second lien tranche of European loans and mezzanine facilities (typically containing a gradual step down in the prepayment premium from 2% in the first year, 1% in the second year, and no call protection thereafter).

Voluntary Prepayments and Debt Buybacks

Although debt buybacks have been less frequent in recent years, the provisions allowing for such prepayments are typically found in both U.S. and European loan agreements.

U.S. loan agreements typically require the borrower to offer to repurchase loans ratably from all lenders, in the form of a reverse "Dutch auction" or similar procedure. Participating lenders are repaid at the price specified in the offer and the buyback is documented as a prepayment or an assignment. Loan buybacks may also take the form of a purchase through non-*pro rata* open market purchases. These purchases are negotiated directly with individual lenders and executed through a form of assignment. Unlike loans repurchased by the borrower (which are required to be cancelled), loans assigned to sponsors or affiliates may remain outstanding. Lenders often cap the amount that sponsors and affiliates may hold and also restrict the right of such sponsors or affiliates in voting the loans repurchased.

Similarly, in European loan agreements, "Debt Purchase Transaction" provisions have been included in LMA recommended form documentation since late 2008. The LMA standard forms contain two alternative debt purchase transaction provisions – one that prohibits debt buybacks by a borrower (and its subsidiaries), and a second alternative that permits such debt buybacks, but only in certain specific conditions (for example, no default continuing, the purchase is only in relation to a term loan tranche and the purchase is made for consideration of less than par).

Where the loan agreement permits the borrower to make a debt purchase transaction, to ensure that all members of the lending syndicate have an opportunity to participate in the sale, it must do so either by a "solicitation process" (where the parent of the borrower or a financial institution on its behalf approaches each term loan lender to enable that lender to offer to sell to the borrower an amount of its participation) or an "open order process" (where the parent of the borrower or financial institution on its behalf places an open order to purchase participations in the term loan up to a set aggregate amount at a set price by notifying all lenders at the same time).

Both LMA alternatives permit debt purchase transactions by the sponsor (and its affiliates), but only subject to the disenfranchisement of the sponsor (or its affiliate) in respect the purchased portion of the loan.

Mandatory Prepayments and Change of Control

U.S. borrowers are typically required to prepay loans incurred under their loan agreements using the net proceeds of certain asset sales, debt not permitted to be incurred under the applicable loan agreement and, in some cases, issuances of equity to third parties. Often, the asset sale prepayment provisions carve out certain types or sizes of dispositions from the sweep, include generous reinvestment rights, and/or include a threshold amount under which the borrower need not use the proceeds to prepay. Some U.S. loan agreements include step-downs permitting borrowers to apply increasingly lower percentages of the net proceeds to prepay loans as leverage declines and allow the borrower to use asset sale proceeds to ratably prepay *pari passu* debt.

In U.S. loan agreements, a change of control usually triggers an event of default rather than a mandatory prepayment as is commonly seen in European loan agreements. Recent Delaware Court of Chancery cases have applied increasing scrutiny to the continuing director change of control provisions, particularly "dead hand" proxy put provisions. The issues raised in the cases include whether a change of control provision may restrict the ability of the existing board of directors to approve a dissident slate; whether a director breaches his fiduciary duty by failing to approve a dissident slate where such failure causes a change of control event of default under an existing credit agreement or indenture; and whether the administrative agent of a company's credit facility aids and abets a breach of fiduciary duty by such company's board due to adoption of a credit agreement containing a change of control provision restricting the ability of existing directors to approve a dissident slate.[11]

Mandatory prepayment provisions continue to shift in the European loan market, as borrowers and lenders seek greater flexibility.

Historically, a mandatory prepayment of the loan facilities triggered by a change of control event would be a standard feature of European loan agreements. This provision would provide relative inflexibility for certain syndicated lenders in the context of an acquisition, effectively imposing prepayment upon them (as a waiver of the borrower's prepayment would typically require all lender consent). However, there has been a notable rise in the inclusion of "put right" provisions for lenders in European loan agreements, akin to the change of control provisions commonly found in high-yield bonds. Whilst the practice of the "put right" provisions in the context of leveraged loans is relatively untested (and the inclusion of a 1% prepayment premium as is common in high-yield bonds remains atypical), these "put right" provisions effectively grant the lenders and borrowers greater flexibility to negotiate terms prior to a contemplated change of control.[12]

The use of controversial "portability" features (present in 11% of European loan agreements in 2017) saw a dramatic decrease in 2018. As with "put right" provisions, the portability concept migrated to the leveraged loan market from high-yield bonds (where greater liquidity serves, in part, to mitigate associated risks for bondholders). In essence, "portability" features permit borrowers to circumvent the usual mandatory prepayment upon a change of control if certain conditions are met. The most common condition dis-applying the change of control mandatory prepayment is a ratio test, whereby prepayment is only required should the borrower not meet the *pro forma* leverage ratio identified in the loan documentation. Through the first half of 2018, just two senior facility agreements contained portability features (and both were restatements of facilities which had previously included the "portability" concept). "Portability" features were also proposed in a small number of European loan agreements through the first half of 2018, but none of these survived the marketing and syndication process.[13]

Similar "portability" provisions are sometimes seen in U.S. loan agreements, but they often require the debt to maintain a given rating (and not be downgraded as a result of the transaction) and/or for the new parent to have a certain market capitalisation in order to avoid the transaction constituting a change of control and, as a result, causing an event of default.

Financial Covenants

Historically, U.S. leveraged loan agreements contained at least two maintenance financial covenants: a leverage test (total, first lien or secured, depending on whether the facility was unitranche or a first lien/second lien deal) and an interest coverage or fixed charge coverage test, each typically tested at the end of each quarter.

In the United States, "covenant-lite" loan agreements (which contain no maintenance or ongoing financial covenants) continue to dominate the leveraged loan market. Through the third quarter of 2018, these loan agreements set record highs and accounted for almost 80% of outstanding loans according to data from S&P Global Market Intelligence. This portion of the market has increased steadily from approximately 64% in August 2015. In certain transactions, the loan agreement might be "quasi-covenant-lite" meaning that it contains only one financial maintenance covenant (usually a leverage covenant) which is applicable only to the revolving credit facility and only when a certain percentage of revolving loans are outstanding at the testing date (20%–30% is fairly typical, but has been as high as 37.5%). Covenant-lite (or quasi-covenant-lite) loan agreements may nonetheless contain other financial ratio incurrence tests – used merely as a condition to incurring debt, making restricted payments or entering into other specified transactions. Unlike maintenance covenants, incurrence-based covenants are not tested regularly and a failure to maintain the specified levels would not, in itself, trigger a default under the loan agreement.

European loan agreements historically included a full suite of ongoing financial maintenance covenants. With the influx of institutional investors and increased demand generally affording borrowers increased bargaining power, "covenant-lite" and "covenant-loose" deal structures are much more prevalent, especially where it is intended that the loan will be syndicated to an institutional investor base. European deal activity in 2018 revealed that just over 80% of loan transactions were "covenant-lite" (consistent with the proportion of "covenant-lite" agreements in the previous year), meaning that the facility contained only a single financial covenant for the revolving facility lenders (usually a leverage ratio covenant tested on a springing basis) or contained no maintenance financial covenant at all. Springing covenants are typically tested only when the revolving facility is between 30% and 40% drawn (excluding backstopped letters of credit, non-backstopped letters of credit up to a threshold and, for a year or two after closing, closing date revolving borrowings up to a threshold amount). Some more aggressive deals include no cap on the exclusion of letters of credit.

In the United States, the leverage covenant historically measured consolidated debt of the Borrower and all its subsidiaries. Today, leverage covenants in U.S. loan agreements frequently apply only to the debt of the Borrower and its restricted subsidiaries (and, as a result, the EBITDA of unrestricted subsidiaries is not included either, unless distributed to the borrower or a restricted subsidiary). Moreover, leverage covenants sometimes only test a portion of consolidated debt – sometimes only senior debt or only secured debt (and in large cap deals of top tier sponsors sometimes only first lien debt). Lenders are understandably concerned about this approach as the covenant may not accurately reflect overall debt service costs. Rather, it may permit the borrower to incur unsecured senior or subordinated debt and still remain in compliance with the leverage covenant. This trend has not yet found its way over to Europe.

In the event a U.S. loan agreement contains a leverage covenant, it likely will be a "net debt" test that reduces the total indebtedness (or portion of debt tested) by the borrower's and its restricted subsidiaries' unrestricted cash and cash equivalents. Some aggressive deals in 2018 did not include certain debt (such as purchase money and capital lease obligations, all subordinated debt, or even any debt up to a fixed dollar amount) in the portion of debt tested. Lenders sometimes cap the amount of cash a borrower may net out to discourage both over-levering and hoarding cash. The trends with regard to netting illustrated borrowers' rapidly increasing success in pushing for greater flexibility.

In Europe, the total net debt test is tested on a consolidated group basis, with the total net debt calculation usually including the debt of all subsidiaries (excluding intra-group debt). Unlike the cap on netted cash and cash equivalents in some U.S. loan agreements, European borrowers net out all free cash in calculating compliance with the covenant.

With strong sponsor backing, borrowers have increasingly eased the restriction of financial covenants by increasing the amount of add-backs included in the borrower's EBITDA calculation. Both U.S. and European loan documents now include broader and more numerous add-backs including transaction costs and expenses, restructuring charges, payments to sponsors and certain extraordinary events. Most borrowers have negotiated add-backs (generally to the extent reasonably identifiable and factually supportable and achieved within a certain time period) for projected and as-yet unrealised cost savings and synergies. Add-backs have also become increasingly vague and flexible – for example, add-backs "of a type" similar to those in the model delivered to arrangers during syndication or cost savings add-backs without a requirement relating to when the savings materialise. The Leveraged Lending Guidance and the federal regulatory agencies enforcing it (discussed further in Part D), though, suggest that regulators may apply heightened scrutiny to definitions of EBITDA that provide for add-backs without "reasonable support". This regulatory scrutiny has led to greater negotiation of EBITDA add-backs for projected improvements in operating results, resulting in more frequent use of limits on the timing for the realisation of anticipated synergies, administrative agent approval of add-backs and caps on savings and synergies add-backs, either by reference to a fixed amount or a certain percentage of EBITDA, typically 15%–25% in the United States. In Europe, similar percentage caps on cost synergy add-backs have generally increased in recent years, from 5%–10% of unadjusted EBITDA in 2015, to 15%–20% in 2018.[14] However, despite this increase, lenders in the European market are becoming acutely aware of the pitfalls of including uncapped EBITDA add-backs in their loan documents. Indeed, the first half of 2018 saw a 10% decrease in the number of European deals containing uncapped add-backs, credited in part to increased regulatory scrutiny by the European Central Bank ("ECB") (discussed further in Part D).

Some U.S. deals with uncapped cost savings add-backs further provided for no time period during which such cost savings must be realised; however, it is typical for deals to include a time period ranging from 12 to 24 months (occasionally 36 months). There may be some negotiation over whether the cost savings must be reasonably expected to be realised during this "look forward" period or whether the borrower only must have taken substantial steps toward the action (instead of the full action) expected to result in such savings within the period.[15] These developments are further evidence of loosening loan terms and the power of sponsors. There has also been a trend of increasingly broad and vague language in EBITDA add-backs (such as the inclusion of all "business optimisation" expenses and references to "cost savings initiatives") which is potentially fertile ground for inflating EBITDA with arguable add-backs. These vague and broad add-backs, together with the uncapped add-backs that may never be realised within the term of the agreement and the other pro-borrower developments regarding add-backs, may weaken the ability of maintenance covenants to protect lenders and artificially permit borrowers even more flexibility to use both their "ratio" baskets.

Equity Cures of Financial Covenants

For the majority of sponsor deals in the United States, loan agreements that contain financial maintenance covenants also contain the ability for the sponsor to provide an "equity cure" for non-compliance. The proceeds of such equity infusion are usually limited to the amount necessary to cure the applicable default, and are added as a capital contribution (and deemed added to EBITDA) for this purpose. Because financial covenants are meant to regularly test the financial strength of a borrower independent of its sponsor, U.S. loan agreements place restrictions on the frequency (usually no more than two fiscal quarters out of four) and absolute number (usually no more than five times over the term of the credit facility) of equity cures.

In Europe, equity cure rights have been extremely common for many years. As in the United States, the key issues for negotiation relate to the treatment of the additional cure equity; for example, whether it should be applied to increase cash flow or earnings, or to reduce net debt (and, if so, whether it should also be applied in prepayment of the facilities). Whilst historically it was restricted to the latter, European deal activity over the last couple of years has revealed a definitive trend towards "EBITDA cures" – that is, cure amounts being treated as an increase in earnings rather than as a reduction in net debt. In 2018, nearly 90% of all loan agreements with equity cures allowed for such EBITDA cures. Similar restrictions apply to equity cure rights in European loan documents as they do in the United States in respect of the frequency and absolute number of times an equity cure right may be utilised. In Europe, the frequency is typically lower (and usually, an equity cure cannot be used in consecutive periods) and is subject to a lower overall cap (usually, no more than two or three times over the term of the facility). However, these restrictions are loosening, with over a third of European loan agreements permitting consecutive cures in 2018 (following the U.S. loan market construct by allowing up to two cures in any four-quarter period). One of the key differences which has remained unchanged between the U.S. and European approaches to equity cures is that, unlike in U.S. loan agreements, "over-cures" are typically permitted in European loan agreements (that is, the ability to inject more equity proceeds than is actually required to cure any financial covenant non-compliance). Such an ability is advantageous to some borrowers by allowing them to obscure any possible future underperformance. Another borrower-friendly trend which has emerged in the European loan market in the last two years has been the "prepayment cure", which allows a borrower to avoid being tested against a springing financial covenant by simply prepaying its revolving loans to a level below the relevant springing test threshold (which, as noted above, is typically set at the revolving facility being over 40% drawn). In most cases, a "prepayment cure" will not require the borrower to cancel the facility by the amount prepaid, and the borrower will not be prohibited from redrawing the prepaid amounts after the (avoided) test date. From a documentation perspective, it is also important to note that there is no LMA recommended equity cure language.

LIBOR Successor Rate Provisions

Notwithstanding the fact that U.S. leveraged loan agreements already include a prime rate interest rate alternative to LIBOR, the loan market began to introduce "fallback" language into loan documentation to enable the transition to a new rate in anticipation of the discontinuation of LIBOR. The LSTA has been working with the Alternative Reference Rates Committee (the "ARRC"), the body tasked with replacing U.S. dollar LIBOR, to develop more robust mechanisms for such fallback provisions. These provisions have three components: the trigger event (such as LIBOR cessation) that causes the transition to a replacement rate; the actual replacement rate and adjustment to the interest rate spread; and any required amendment process. In September 2018, the ARRC released a consultation that explored two approaches to fallback provisions. Similar to what occurs in the loan market today, the "amendment" approach involves the borrower and agent identifying a replacement rate and spread (subject to the negative consent of the required lenders under the loan agreement). The "hardwired" approach automatically incorporates a waterfall of replacement rates and spreads upon the trigger event.[16] Market feedback to the ARRC consultation indicated that 46% of respondents identified the hardwired approach as the ultimate preference, 41% preferred the amendment approach, and 14% chose both approaches.[17]

In Europe, the LMA also has been proactively preparing for the possible discontinuation of LIBOR beyond 2021 by encouraging both borrowers and lenders to consider the implications of such a change in their loan documents. Working in conjunction with the Sterling Working Group, the LMA have substantively revised their precedent "Replacement Screen Rate" clause, and published a comprehensive User Guide pertaining to the same in October 2018. The expanded provision actively encourages parties to European loan agreements to consider and negotiate scenarios in which replacement rates for LIBOR may be triggered, as well as hard-wiring the subsequent steps into their loan documentation. Approximately 92% of European loan agreements through the first half of 2018 included LIBOR successor rate language, reflecting the market's awareness of the potential consequences of a discontinuation of LIBOR.[18]

Sanctions, Anti-Money-Laundering and Anti-Bribery Provisions

Both European and U.S. loan agreements include representations, warranties and covenants relating to anti-bribery, anti-money-laundering and sanctions laws locally and abroad (the "Anti-Corruption/Sanctions Laws"). In the U.S. market context, SunGard provisions (discussed in Part A) identify representations with respect to Anti-Corruption/Sanctions Laws as specified representations, though these sometimes have "use of proceeds" qualifications. Similarly in the European market, lenders invariably insist on such representations being characterised as "major representations" for certain funds purposes. Negotiation of these provisions may focus on whether it is appropriate to limit these provisions by materiality and/or by knowledge. Both European and U.S. borrowers often are concerned about their ability to fully comply with broadly drafted provisions without some form of knowledge, scope and/or materiality qualifiers.

Part C – Syndicate Management

Voting Thresholds

In U.S. loan agreements, for matters requiring a vote of syndicate lenders holding loans or commitments, most votes of "required lenders" require only a simple majority of lenders (that is, more than 50% of lenders by outstanding loans and unused commitment size) for all non-unanimous issues. In European loan agreements, most votes typically require a voting threshold of two-thirds through it is increasingly common to see this reduced to a simple majority. In some, but not all, European loan agreements, certain votes that would otherwise require unanimity may instead require only a "super-majority" vote, ranging between 85%–90% of lenders by commitment size. Such super majority matters typically relate to releases of transaction security or guarantees, or an increase in the facilities (though not an increase that might result in an obligation to fund on the part of the non-consenting lender).

"Unanimous" decisions in U.S. loan agreements are limited to fundamental matters and (other than voting provisions and *pro rata* sharing provisions) require the consent only of affected lenders (and are not, therefore, truly unanimous), whilst in European loan agreements (except where they may be designated as a super majority matter), decisions covering extensions to commitment periods, payment dates and reductions in amounts payable (even certain mandatory prepayment circumstances), changes to currencies and commitments, transfer provisions and rights between lenders all typically require the unanimous consent of lenders (not just those affected by the proposed changes).

Because of its adherence to requiring 100% lender consent to extend, the European market does not typically provide for amend and extend provisions that permit borrowers to extend their loan's maturity with only the consent of the extending lenders (which is not unusual in the U.S.). Instead, European borrowers have turned to the forward start facility, which is structured as a new loan agreement that sits beside the existing loan agreement but is not drawn until the existing facility matures. The forward start facility is used solely to refinance the indebtedness outstanding under the existing loan agreement.

Yank-a-Bank

U.S. loan agreements often contain provisions allowing the borrower to remove one or more lenders from the syndicate in certain circumstances. A borrower may, for example, remove a lender where such lender refuses to agree to an amendment or waiver requiring the unanimous consent of lenders (or all affected lenders), if the "required lenders" have consented. Other reasons a borrower may exercise "yank-a-bank" provisions are when a lender has a loss of creditworthiness, has defaulted on its obligations to fund a borrowing or has demanded reimbursement for certain increased cost or tax payments. In such circumstances, the borrower may require the sale of the lender's commitment and loans to another lender or other eligible assignee, and some loan agreements will permit the borrower to repay loans and terminate commitments of such lenders on a non-*pro rata* basis. In most European loan agreements, yank-a-bank provisions are also routinely included and are similar in mechanism and trigger events.

Snooze-You-Lose

In addition to provisions governing the required votes of lenders, most European loan agreements will also contain "snooze-you-lose" provisions, which favour the borrower when lenders fail to respond to a request for an amendment, consent or waiver. Where a lender does not respond within a specific time frame, such lender's commitment is ignored when calculating whether the requisite vote percentage have approved the requested modification. Similar provisions are rare in U.S. loan agreements.

Transfers and Assignments

In European loan agreements, lenders may assign their rights or otherwise transfer by novation their rights and obligations under the loan agreement to another lender. Typically, lenders will seek to rely on the transfer mechanism, utilising the standard forms of transfer certificates which are typically scheduled to the loan agreement. However, in some cases, an assignment may be necessary to avoid issues in some European jurisdictions which would be caused by a novation under the transfer mechanic (particularly in the context of a secured deal utilising an English-law security trust, which may not be recognised in some European jurisdictions).

Historically, most sub-investment grade European deals provided that lenders were free to assign or transfer their commitments to other existing lenders (or an affiliate of such a lender) without consulting the borrower, or free to assign or transfer their commitments to a pre-approved list of lenders (a white list), or not to a predetermined list of lenders (a blacklist). However, over the course of 2017 and 2018, there has been a marked trend in transfer restrictions. Indeed, restrictions on transferring commitments to "competitors" of the borrower were present in more than 80% of European loan agreements through the first half of 2018, usually without any reasonableness qualification (a level consistent with the same period in 2017). Another trend has been the increasing restrictions on transfers to loan-to-own and distressed investors, which in 2018 was seen in two thirds of large-cap European loan agreements. For stronger borrowers in both Europe and the United States, the lenders must usually obtain the consent of the borrower prior to any transfer or assignment to a lender that is not an existing lender (or affiliate).

In the United States, the LSTA has recommended, and most loan agreements include, "deemed consent" of a borrower where a borrower does not object to proposed assignments within five to 10 business days, which is the same position taken in the European market. Similar to stronger European borrowers and sponsors who are able to negotiate a "blacklist", most borrowers and sponsors in the United States negotiate a "DQ List" of excluded (disqualified) assignees. In both the European and U.S. contexts, the DQ List or blacklist helps the borrower avoid assignments to lenders with difficult reputations. In the U.S. market, competitors and their affiliates are often included in the DQ List. Sponsor-backed and large cap borrowers in the United States commonly push for expansive DQ lists and the ability to update the list post-closing (but lenders try to limit these updates to competitors and new affiliates). However, this development has not made its way to European loan agreements. The ability to update the DQ List post-closing could present problems in a workout scenario by giving the borrower veto power over any assignments or sales by lenders to third parties. On the other hand, deals frequently provide the borrower no consent rights over lender assignments following an event of default which can also be problematic if lenders desire to sell the loan to a "loan to own" fund.

Part D – New Regulatory and Legal Developments in the Loan Market

Leveraged Lending Guidance

U.S. federal bank regulators indicated during the third quarter of 2014 that they would more carefully scrutinise leveraged lending issuances following their determination that a third of leveraged loans they reviewed did not comply with the Leveraged Lending Guidance (the "U.S. Guidance") issued in March 2013 by the Federal Reserve, the OCC and the FDIC. The U.S. Guidance provides, among other things, that a leverage level in excess of 6.0× total debt over EBITDA will raise regulatory concern for most industries and may result in the loan being criticised (as discussed further in in Part B). In addition, the U.S. Guidance provides that a borrower should be able to amortise its senior secured debt or repay half its total debt with five to seven years of base cash flows.

Regulators have identified some specific ways the U.S. Guidance may affect credit agreement provisions or features. For example, regulators have said they will be critical of credit agreement terms that allow for the material dilution, sale, or exchange of collateral or cash flow-producing assets without lender approval. Sidecar loan agreements or accordion features that allow borrowers to incur more debt without protecting the existing lenders may attract regulatory scrutiny. EBITDA adjustments must be supported by third-party due diligence and a "large-percentage" adjustment will attract regulators' suspicion. Regulators have said that because refinancings or modifications count as originations to which the U.S. Guidance applies, any refinancings or modifications of non-pass loans must show meaningful improvements to structure or controls to avoid being criticised. Such improvements might be new or tightened covenants, additional collateral or restrictions on acquisitions.

Supplementary regulatory commentary provides that failure to adhere to these requirements is not a bright line bar to an issuance if there are other mitigating factors. The lack of a bright line rule may permit some loan issuances that do not achieve complete compliance, but it also introduces significant uncertainty into the process of underwriting a loan issuance for sponsors, borrowers and lenders alike. Experts predicted that the U.S. Guidance could result in more borrowers electing to use non-regulated institutions as agents and lenders, and, as predicted, since 2015, non-regulated financing sources have continued to be more active with respect to loans that might have been criticised. This trend is not without problems. Sponsors are wary of trusting the execution of large deals to non-regulated financing sources, and borrowers are hesitant to rely on revolving commitments from them. Also, overreliance on non-regulated financing sources could create a liquidity problems in a few years when borrowers seek to refinance (regulators have indicated that the U.S. Guidance may be applied to a refinancing). Regulators are considering regulations to address the non-regulated financing sources loophole.

The federal regulators noted in a 2016 review that the banks have made progress in compliance with the U.S. Guidance as the number of non-pass loan originations in the U.S. market reached *de minimis* levels. But the regulators cautioned that some weaknesses in underwriting practices still exist, including liberal repayment terms, structures with "ineffective or no covenants", incremental debt provisions that allow for debt to a level that inhibits deleveraging capacity and dilutes senior secured creditors and unreasonable add-backs to EBITDA. Further, part of the decrease in non-pass originations is attributable to the liberal use of add-backs that increase EBITDA substantially, thereby decreasing the leverage ratio below 6.0×. For example, when the Ultimate Fighting Championship put itself up for sale, add-backs to its EBITDA increased its earnings from $170 million in the initial calculation to $300 million in the presentation given to debt investors (which decreased its leverage ratio to 6.0×). This large increase in EBITDA would permit substantially more debt to be incurred in connection with the sale. Regulators caught on and cautioned Goldman Sachs, the arranger. When Bain Capital decided to buy online jeweller Blue Nile, add-backs increased Blue Nile's EBITDA from approximately $19 million to approximately $45 million, dropping its leverage ratio from 9.0× to 4.0×. The concern of regulators is that, regardless of the decrease in non-pass originations, this type of creative accounting does not represent true progress toward tighter underwriting practices.

In February of 2018, Comptroller of the Currency Joseph Otting confirmed, at the SFIG Vegas conference, that the U.S. Guidance was intended to be just that – guidance – and not a rule or regulation.[19] Further, in May of 2018, he went on to say that, as a result, he did not see a reason to amend the U.S. Guidance – lending outside of that guidance is acceptable, as long as an institution is doing so in a prudent manner.[20] Not surprisingly, adjusted leverage levels in the United States have increased and larger adjustments to EBITDA have increased unadjusted leverage even higher. In 2018, 30% of all deals were levered 6.0× or more, and 28% included add-backs in an amount greater than 50% of unadjusted EBITDA. A notable share (13%) in this sampling had adjustments above the 100% mark.[21] Recent trends indicate that the U.S. Guidance, while not being ignored, may be losing some of its power as total leverage in 2018 reached record highs since 2007.[22] The Federal Reserve's November 2018 Financial Stability Report indicated that systemic risk and overall vulnerabilities in the financial system are at moderate levels.[23]

Similar leveraged lending regulations have recently been introduced in Europe. On May 16, 2017, the ECB published its long-awaited guidance to banks regarding leveraged transactions (the "ECB Guidance"), effective November 2017. Whilst the ECB Guidance is not legally binding, affected institutions are expected to incorporate the ECB Guidance into their internal lending policies (in line with the size and risk profile of each banks' leveraged transaction activities relative to their assets, earnings and capital). The guidance outlines the ECB's expectations regarding risk management and reporting requirements, with a stated aim of providing senior management a comprehensive overview of the bank's leveraged lending activities.[24] The ECB Guidance applies to all "significant credit institutions" supervised by the ECB under the "Single Supervisory Mechanism". It does not, however, apply to "credit institutions" based in member states outside the Single Supervisory Mechanism and not directly supervised by the ECB (such as the United Kingdom, although the Bank of England has itself from time to time considered leveraged lending levels).

For the purposes of the ECB Guidance, a "leveraged" transaction includes all types of loans or credit exposure where the borrower's post-financing level of leverage (i.e. the ratio of total debt to EBITDA) exceeds 4.0×, as well as all types of loan or credit exposure where the borrower is owned by one or more financial sponsors. Under the ECB Guidance, affected credit institutions are expected to ensure that transactions which have a "high level" of leverage – meaning transactions where the ratio of total debt to EBITDA exceeds 6.0× at the time of deal inception – remain "exceptional" (in a similar vein to the U.S. Guidance).

However, the effectiveness of the ECB Guidance remains in question. Since the guidance became effective in November 2017, several European loan transactions have exceeded the 6.0× recommended limit, with deals featuring leverage of up to 8.0×. It remains to be seen whether the ECB Guidance can withstand continuing borrower-pressure for more favourable terms, as well as its own operational shortcomings.[25]

Conclusion

As highlighted in this article, it is important for practitioners and loan market participants to be aware of the key differences in the commercial terms and market practice in European and U.S. leveraged loan transactions. Whilst there are many broad similarities between the jurisdictions, borrowers and lenders that enter into either market for the first time may be surprised by the differences, some of which may appear very subtle but which are of significance. As more and more borrowers are prepared to look beyond their domestic market and willing to seek access to whichever debt market (whether U.S. or European) offers greater liquidity and more favourable pricing and terms at any given time, and as a wider range of alternative and non-bank investors are attracted to the investment opportunities presented by both the European and U.S. loan markets, the importance of having a general understanding of the differences is now even more critical.

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The Global Subscription Credit Facility and Fund Finance Markets – Key Trends and Forecasts


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Introduction

The Subscription Credit Facility (each, a "Facility") and related Fund Finance markets continued their extensive growth and positive momentum in 2018. Like virtually every year since the financial crisis, lender ("Lender") Facility portfolios grew extensively this year, in spite of meaningful headwinds and challenges. The market grew more dynamic and accustomed to frequent evolution and change. This chapter summarizes the key developments in the Facility and Fund Finance markets in 2018 and forecasts our expectations for the coming year.

Cadwalader 2018 Representations

Because the Fund Finance market is not public, it remains challenging to find actual data to support instincts and suspicions. To help our clients address that, Cadwalader performed a data analysis in January where we evaluated every transaction in 2017 and 2018 in which we represented the lead Lender. Our touch points with the market are extensive and as a result provide a relatively robust data set that is a good proxy for the U.S. market as a whole:

	2017	2018	Change (%)
Number of Deals	111	133	+20%
Aggregate Lender Commitments	$41.65bn	$46.34bn	+11%
Number of Banks Participating in Our Deals	42	40	-5%
Number of Sponsors	72	90	+25%

We draw on this data where relevant in this chapter.

Resilient Growth

There were a host of headwinds that should have muted the growth of the Fund Finance markets in 2018, but did not. Fund formation, the fundamental driver of Fund Finance, was materially down from 2017. Private equity data provider Preqin's initial figures show that the number of funds (each, a "Fund") closed in 2018 (1,733, down 28% from 2017) and aggregate capital raised ($757 billion, down from $925 billion in 2017) were both down. One-sided and negative articles in both the private equity and mainstream media continued to decry "abuse" almost weekly.[1] Limited Partners ("Investors") more frequently capped Facility size around 25% of Fund size. There was a very public default. Banks struggled with exposure limits to Fund Finance established by their risk departments, heightened awareness and information requests from regulators, banker turnover and unfilled positions. And yet portfolio growth marched on.

We believe global Lender commitments increased by 15–20% in 2018, materially exceeding our estimates for the year. We now estimate the global market at approximately $525 billion. All of the data points in our portfolio and the business metrics we track (number of deals (up 20%), Lender commitments (up 11%), number of discreet engagements, volume of hours billed, revenue, etc.) support these growth estimates. And anecdotal reports from Lenders in the market often exceed 20%.

So how does the Facility market continue to grow despite lower Fund formation statistics and other challenges? At a high level, the answer is simply market acceptance. The message in the ILPA Guidelines and from Investors generally has not been to push back on Facilities *per se*. Rather, the message has been requests for transparency, increased reporting and individual loan tenors not exceeding 365 days or another agreed maximum length. This messaging has made it clear to Fund sponsors ("Sponsors") that disciplined use of Facilities is permissible and likely even welcomed by Investors, leading to more widespread usage. While at times it can feel like Facilities are ubiquitous in the market, back of the envelope math suggests there is still further growth available by market penetration. Various estimates of dry powder peg the globe's aggregate uncalled capital from Investors to Funds between $1.9 trillion and $2.3 trillion. We estimate the global Facility market at $525 billion. A Facility advance rate of around 25% would be atypically low, strongly suggesting there is still inherent global demand in the macro.

"Structural Drift"

Jeff Johnston, Managing Director at Wells Fargo, used the term "Structural Drift" at a conference late last year aptly to describe how Facility terms continue to creep incrementally in favor of borrowers. Advance rates are ticking up slightly, concentration limits are continuing to relax and credit linkage around subsidiary investors is informalizing. The market is adjusting to Funds bringing their leveraged finance playbooks to Facility discussions and the resulting conflict it has with Lenders' relationship-based approach to the product area. But for the most part, transaction structures have held remarkably consistent, and the drift in favor of borrowers has been accommodative but not disruptive.

Partnership agreements are becoming more explicit around the permissible scope and tenor of Facilities, a likely fall out from the ILPA Guidelines and the press coverage. Lenders tend to see all of this as a credit positive; Investor engagement and understanding around Facilities reduces the risk of an Investor credibly disclaiming knowledge of a Fund's authority to pledge capital commitments. Increasing concentration in the top-tier fund formation law firms is also aiding partnership agreement improvements.

A prohibition on overcalls for the purpose of paying management fees is an increasingly common partnership agreement challenge. Funds of course want to borrow under the Facility to pay management fees; Lenders of course structure Facilities with a borrowing base for the precise reason of having a buffer to absorb Investor defaults. While many Lenders will not entertain this risk, there are some compromises making headway in the market:

(i) The Lender will lend to the Fund for management fees, but the management company agrees to indemnify the bank for any losses incurred as a result of the management fee overcall prohibition (i.e., if the Lender lends for management fees and is not repaid because of the overcall prohibition, the management company gives the fees back to the Lender).

(ii) The Lender will only lend for management fees if the NAV of the Fund exceeds a comfortable threshold amount to bolster the Lender's secondary source of repayment.

(iii) The Lender will lend for management fees, but only if (a) there are no defaulting investors to date, and (b) the Fund agrees to clean down the borrowing within 90 days.

Credit Performance

A. Abraaj. In a first for the modern Fund Finance market, an event of default on a Facility has been playing out publicly in the press. Private Equity International has been covering the Abraaj matter extensively, including their November 26, 2018 article "*What happens when subscription credit lines turn sour?*"[2] While we cannot comment on the accuracy of the factual details articulated in the article, an event of default has clearly occurred, albeit under particularly isolated and exceptional facts. The market eagerly awaits each additional development in the Abraaj insolvency.

B. The Market Generally. Outside of Abraaj, however, the Facility market (as well as NAV-based and hybrid facilities) all performed exceptionally well from a credit perspective in 2018. Our portfolio had no monetary defaults and the only exclusion events that came to our attention involved a very limited number of high-net-worth investors.

Pricing and Tenor

Facility pricing has held steady throughout 2017 and 2018, with virtually no correlation between spreads and time over the past two years. According to our data, Facilities to separately managed accounts priced on average 20 basis points wider than Facilities to commingled Funds. Hybrid Facilities on average priced 78 basis points wider. We see almost no correlation between the existence of an overcall limitation and Facility pricing—quite a curious revelation in light of how seriously Lender credit teams take overcall limitations… Tenor is more variable. Our portfolio splits in near perfect thirds between one-, two- and three-year tenors. Only a small handful of deals extended beyond three years on a committed basis.

Industry Developments

A. Lender Hiring. Lenders hired extensively in 2018, often from each other. Headlined by Tom Byrne joining Signature Bank in August and then proceeding to hire multiple well-known Fund Finance managing directors, many senior bankers switched teams. The turnover has created a lot of career opportunities throughout the industry and upward pressure on Lender compensation.

B. Fund Finance Servicer Providers. Several firms added Fund Finance product offerings in 2018, evidence of the maturation of the industry. Validus Risk Management created a Fund Finance Advisory practice in London, led by former Lloyds Bank banker Sarah Lobbardi. Vanbridge, an insurance solutions provider based in New York, has started consulting with Lenders on potential risk transfer solutions for their Facility portfolios. A recruiting and placement firm is nearing a brand launch announcement. We expect more such product and company start-ups to enter the industry in 2019.

C. Fund Finance Friday. Cadwalader launched Fund Finance Friday, a weekly market intelligence and update newsletter, last fall. Styled more like a "*5 Things to Know to Start Your Day*" update piece and not like a traditional legal memorandum, it has quickly grown to over 1,000 subscribers. Not surprisingly, the job postings tend to get the most clicks each week. If you are interested in subscribing (there is no charge), visit https://www.cadwalader.com/fund-finance-friday.

D. Publications. Global Legal Group Ltd., the publisher of this guide, published the third edition of *Global Legal Insights – Fund Finance 2019*, now known in the market as the "Pink Book". The guide includes 21 product-oriented chapters and 22 jurisdictional updates contributed by many of the world's preeminent Fund Finance law firms, a substantial improvement over the prior editions.[3]

2019 Forecasts

For 2019, we forecast a growth rate in Lender portfolios of 12%–17%, although we do not think that growth will be absorbed uniformly across all Lenders. While there will be challenges, the sheer volume of flagship Funds from preeminent Sponsors slated to close in 2019 will absorb very large amounts of additional Facility commitments. We believe some of these premier Sponsors will be adding new lenders to their syndicates this year to ensure diversity of funding sources. We think "Structural Drift" will continue at the margins, but will be somewhat offset by Lenders' requests for improvements based on lessons learned from the Abraaj defaults. We do forecast Investor interest in Facilities to continue to increase, heightening the importance of partnership agreement and side letter due diligence.

While we do not contemplate banker transitions as wholesale as last year, we do think hiring is likely to continue at a brisk pace. We expect a fair number of industry veterans to change banks in the front half of the year, creating opportunities for younger bankers. Lenders continue to wrestle with exposure limits to the industry and specific sponsors, and thus, interest in risk transfer solutions is going to increase. Lenders that have historically transacted on a bilateral basis are going to more frequently be looking for syndicate partners. The insurance industry is also likely to play a bigger role in the market going forward. This is likely to result in greater conformance to market standard documentation, as Lenders are going to want to ensure their paper is liquid in the secondary market.

2019 Fund Finance Events

The Fund Finance Association has updated its conference slate for 2019. The 9th Annual Global Fund Finance Symposium moved from New York to Miami, and took place at the Fontainebleau Hotel over three days from March 24–26. The 5th Annual European Fund Finance Symposium has moved to June and will again be held at the Landmark Hotel on June 20, 2019. The 3rd Annual Asia-Pacific Fund Finance Symposium is scheduled for September 24, 2019, again at the Four Seasons hotel in Hong Kong. The Cadwalader Finance Forum is on for October 17, 2019 at the Ritz-Carlton in Charlotte, North Carolina.

Conclusion

The Facility market appears poised for another solid year in terms of portfolio growth in 2019. While the Abraaj matter will be watched closely throughout the year, we continue to believe that the credit profile of market-structured Facility transactions forecasts well for Facility performance. The dynamic nature and constant change in the market will make for a fun and interesting year for industry participants.

Endnotes

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2. The article is accessible at: https://www.privateequityinternational.com/happens-subscription-credit-lines-turn-sour/?login=success.
3. An electronic copy of *Global Legal Insights – Fund Finance 2019* can be accessed at https://www.globallegalinsights.com/practice-areas/fund-finance-laws-and-regulations.

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Recent Developments in U.S. Term Loan B

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Introduction

The U.S. leveraged loan market was the second highest year on record by volume, just falling short of volumes in 2017. M&A and other event-driven new-money financings led the way in 2018 as opportunistic repricings and refinancings fell from 2017 levels. 'Yankee' loans issued by European borrowers in the U.S. market also had a strong year, finishing slightly behind 2017 levels.

Despite the high volume overall, 2018 ended the year on a quiet note as U.S. leveraged loans were caught up in the broad market sell-off in the fourth quarter that likewise impacted the equity and high-yield bond markets. As a result, syndication of some loans was pushed into 2019, while others saw their pricing widen and saw investors successfully push back on covenant provisions.

Overall, however, the gains for investors were modest and loan documentation in the U.S. market continued its trend towards favorable terms for Term Loan B (***TLB***) borrowers, which has been a consistent theme for the last few years. This article examines some of those developments.

Market Fundamentals

Attitudes

Investment banks in today's TLB market operate an originate-to-distribute model, arranging the financing package before distributing all or a significant portion of TLBs to investors (although they will usually retain part of the revolving or other liquidity facility, which is still the domain of traditional banks). The ultimate TLB holders are more likely to be non-bank lenders, i.e. institutional investors such as hedge funds and issuers of collateralized loan obligations (***CLO***s).

Institutional investors take a different approach to their participation in a loan syndicate when compared to traditional banks, viewing loans as liquid, tradable and impersonal investments, rather than part of a broader banking relationship with that borrower. Individual investors buy and sell loans opportunistically instead of holding them to maturity, meaning that they are less reliant on the protection that a more traditional term loan covenant package affords. An institutional investor's overall portfolio will include high-yield bonds as well as loans and, accordingly, institutional investors have gotten comfortable with high-yield incurrence-based covenants for both bonds and leveraged loans in their portfolio (and a lack of financial maintenance covenants). Sponsors and borrowers have been able to use this shift in composition of the lender base, as well as the strong demand for the TLB product, to their advantage in order to push for greater flexibility in terms, in the knowledge that investors will continue to tolerate weaker covenant packages and 'cov-lite' structures as long as the debt is sufficiently liquid. The increase in secondary market activity, absence of a close relationship between a borrower and its lenders and increasing syndicate sizes mean that covenant flexibility becomes even more important for a borrower, as larger and more impersonal syndicates mean that amendments to loan documentation cannot be quickly, easily or cheaply obtained.

Legal and regulatory developments

(a) Leveraged Lending Guidance

The impact of the Leveraged Lending Guidance (***LLG***) jointly issued in 2013 by the Board of Governors of the Federal Reserve System, the Office of the Comptroller of the Currency and the Federal Deposit Insurance Corporation (collectively, the ***Agencies***) has been widely reported but its influence on the market diminished considerably in 2018 as compared to years prior for reasons discussed below. Under the LLG, banks are required to report all leveraged loans to the Agencies for *post-hoc* review, and the Agencies have the power to find that banks under their supervision are engaged in unsafe and unsound banking practices. The LLG states that the Agencies will apply additional scrutiny to transactions where leverage levels exceed 6.0x and/or the borrower is not able to repay all senior debt or half of total debt within five to seven years.

As compared to earlier years, the LLG is notably having less of an impact in terms of reducing overall leverage for corporate borrowings. In 2018, leverage multiples above 6.0x on financings supporting LBO activity in the U.S. were at their highest proportions ever. There were various reasons for this: sponsors and arrangers have relied on more adjustments and add-backs when determining the "adjusted EBITDA" number presented to TLB investors while, at the same time, unregulated non-bank lenders have demonstrated a willingness to finance highly leveraged deals and increased their market share in terms of volume in 2018. The rise in leverage multiples also indicates that the market expected a more relaxed approach to enforcement by the Agencies under the current U.S. presidential administration. Doubts raised by Senator Pat Toomey in October 2017 concerning the validity of the LLG and whether they constituted a 'Rule' for the purposes of the Congressional Review Act (therefore requiring Congressional approval) showed that the LLG did not have the political support it once did. In February 2018, the Office of the Comptroller of the Currency stated publicly that it would not challenge bank activities that violate the guidelines provided that a bank's "safety and soundness " is not impaired. Most recently, in September 2018, the Federal Reserve Board, the Bureau of Consumer Financial Protection, the Federal Deposit Insurance Corporation, the National Credit Union Administration, and the Office of the Comptroller of the Currency issued a joint statement clarifying that supervisory guidance is not legally binding and that agencies do not issue enforcement action based on supervisory guidance. Although not mentioned by name, the joint statement appears to have been issued in order to rebut the notion that the LLG is effectively law.

(b) U.S. LIBOR Replacement

With the approach of the LIBOR sunset in 2021, U.S. market participants are hurriedly looking for successor rates. Of note, the New York Federal Reserve Bank (***NY Fed***) has worked for years to promote alternative reference rates to replace LIBOR in floating rate debt instruments. On September 24, 2018, the Alternative Reference Rate Committee (***ARRC***), a committee organized by the NY Fed, proposed contractual language that can be inserted into U.S. syndicated loan agreements in order to replace LIBOR as the reference rate for syndicated loans in the market. While most U.S. syndicated loans have fall back provisions if LIBOR is unavailable, these provisions are intended to address temporary disruptions in LIBOR, not a permanent switch in the reference rate. The Secured Overnight Financing Rate (***SOFR***) is ARRC's preferred rate to replace LIBOR. SOFR is a reference rate established by the NY Fed and has been published since March 2018. SOFR is the average rate of the cost of borrowing cash overnight collateralized by US Treasury securities. Recently, many borrowers have amended their credit agreements to provide that the administrative agent and the borrower (often with negative consent of the required lenders) will endeavour to establish an alternative rate based on the then prevailing market convention for determining such rate in syndicated loans in the United States. However, it will be interesting to see if US loan agreements incorporate the NY Fed's proposed language and whether the market settles on SOFR or another successor rate.

(c) LSTA Loan Documentation

A growing trend in recent years has been the move towards standardized loan documentation in the U.S. market. The Loan Syndication and Trading Association (***LSTA***) continues to publish standardized loan documents and is increasingly taking on a more active role in the primary market. In 2014, the LSTA released new versions of its primary documents including an expanded publication of its Model Credit Agreement Provisions. In 2017, the LSTA published the second edition of its Complete Credit Agreement Guide. Most recently, in April 2018 and October 2018, respectively, the LSTA published its "Incremental Facility Amendment to Credit Agreement" and its "Model Credit Agreement Provisions for Investment Grade Revolving Credit Financings". This trend towards standardized documentation in the U.S. mirrors the use of Loan Market Association documentation in parts of Europe and we fully expect it to continue in the years to come.

(d) Tax Cuts and Jobs Act

Another legal development we continue to watch is, of course, the impact of the Tax Cuts and Jobs Act, which brought about the most extensive changes to corporate taxation in the U.S. in a generation including the reduction in the corporate tax rate from 35% to 21% and the caps imposed on deductions for net business interest expense at 30% of adjusted taxable income or ATI, calculated to approximate EBITDA initially, and then EBIT from 2022 onwards. In addition, deductions for interest paid to foreign related parties are subject to further limitations (under a "base erosion anti-avoidance tax" or "BEAT"), affecting "push downs" of debt to US affiliates of non-US borrowers. Given that interest deductibility in respect of acquisition financing is a prominent tool employed by sponsors to maximise their returns on highly leveraged buy-outs, it remains to be seen whether these tax reforms will succeed where the LLG has so far failed in limiting the overall leverage multiples for corporate borrowings in the U.S. while providing some incentive to shift debt to a group's foreign subsidiaries.

Notably, the act retained the "deemed dividend" provisions of Section 956, which historically have been the basis of excluding non-US subsidiaries from the guarantee and collateral requirement in credit agreements, while also introducing new provisions that change the tax code from a worldwide to a "territorial" regime in order to incentivize US-parented companies to repatriate earnings. Given, however, that pre-2018 earnings of non-US subsidiaries have already effectively been deemed distributed (under a "transition tax") and given that certain post-2017 foreign earnings can be distributed free of tax (either through a "participation exemption" or because the earnings are previously taxed under either Subpart F or as "global intangible low taxed income"), the legislation has carved a path to implement pledges and guarantees that would not previously have been possible without adverse effects under Section 956.

On October 31, 2018, the US Treasury proposed regulations under Section 956 that would remove the need for actual dividends from non-US subsidiaries to avoid the potential adverse effects of Section 956. The proposed regulations do this by generally providing that non-US subsidiaries earnings required to be included in the income of a US shareholder under Section 956 will qualify for a 100% dividend received deduction if an actual dividend of those earnings would have qualified. The practical effect of this new rule will be to permit US parent corporations to grant pledges of all the shares and assets of their non-US subsidiaries with a lower likelihood of triggering adverse US tax consequences.[1] Thus, while the tax changes are still being digested by the market, they could lead to changes in certain credit agreement provisions, particularly around guarantor coverage, restricted payments and excess cash flow provisions. We note, however, that as of the start of 2019, the legislation does not appear to be impacting security packages on new debt.

Economic Terms

Pricing

The squeezing of loan margins and the continued cycle of repricings tailed off in 2018. Instead, we saw a modest increase in margins in the summer and a larger increase in December, in each case in no small part from the exercise of market flex provisions during syndication. Both of these periods experienced a low volume of loans and therefore had more lender-favorable market fundamentals.

With four separate borrowing rate hikes in 2018, LIBOR now stands well above the typical floor rate so leveraged loans have become true floating rate instruments once again, just as they were before the financial crisis. While a 1% LIBOR floor remained typical in 2018, we saw an increasing trend towards lower LIBOR floors and increasingly at 0.0% or with no floor at all, which had previously been more a feature of the European market.

Optional prepayments

Unlike bonds, investors still generally accept that a TLB is prepayable without penalty or premium. And although the volume of repricings dipped in 2018 as compared to 2017, borrowers still took advantage of existing demand in the market to reprice (either by way of an amendment to a loan agreement or a refinancing of outstanding loans) and looked to do so even fairly quickly after initial issuance.

As a result, investors continue to demand that some limited pricing protection be included in TLB facilities from the outset. The typical protection is a 1% prepayment premium for refinancings at a lower interest rate within an agreed period of time (known as 'soft call' protection). In 2018, the majority of soft call protection provisions included a 'sunset' of six months, while a minority lasted for a full year after initial issuance. While soft call protection as a concept remained, borrowers continued to press for broader exceptions to the requirement to pay a prepayment premium, including when prepayments are made in connection with another transaction, such as a material acquisition, a change of control or an IPO. The broadest formulation of such a carve-out permits a prepayment without a premium where the repricing of the loan is not the 'primary purpose' of the transaction, which featured in the majority of leveraged loans with soft call protection in 2018.

Mandatory prepayments

Mandatory prepayment requirements became slightly more onerous in 2018 as compared to 2017, reversing the trend in TLB that lenders have pulled back from requiring borrowers to de-lever with excess cash. In particular, in 2017, if certain leverage thresholds were met in connection with an asset disposition, the percentage of asset sale proceeds which were required to be used to pay down the TLB would step down (a concept borrowed from the Excess Cash Flow (***ECF***) sweep provision). Although this concept carried over into 2018, it was much less prevalent than in 2017, particularly in the fourth quarter where its inclusion in sponsor loans reduced by half.

Nonetheless, there were other borrower-friendly trends in mandatory prepayments that continued in 2018. ECF sweeps were absent from some sponsored deals and, where they were included, were often undermined by borrower-friendly deductions and carve-outs to the definition of ECF, as well as minimum thresholds for ECF before a prepayment is required.

Restrictive Covenants

Due to the market slow down at the end of 2018, some of the loans issued in the third and fourth quarter experienced successful investor pushback on loose provisions. Overall, however, these gains were modest and TLB terms continued to loosen in 2018.

In 2018, the format and structure of the covenants in TLB, for the most part, remained consistent. TLB facilities have until now generally resisted incorporating the form of high-yield covenants wholesale, although this approach has been seen in some circumstances, usually where the TLB sits alongside high-yield bonds in the capital structure. While the use of high-yield covenants in a TLB is still very much an outlier, the substance of TLB covenants continued to become more akin to high-yield bond incurrence covenants, where many corporate actions are permitted subject to the meeting of certain ratios on the date of such action. For example, most TLB facilities keep payments to shareholders (also known as 'restricted payments'), investments and prepayments of subordinated debt as separate covenants but have builder baskets and general baskets that net across the three covenants. This bond-like flexibility allows borrowers more and more to enter into strategic transactions and incur or refinance debt without seeking the consent of their lender syndicate and without incurring the associated consent fees otherwise required to be paid.

As in high-yield bond indentures, TLB facilities also now typically include the concept of restricted and unrestricted subsidiaries, where the borrower may designate certain subsidiaries as unrestricted subsidiaries. Unrestricted subsidiaries are not subject to guarantee and security requirements, compliance with covenants and events of default, but their EBITDA and earnings (and debt) are excluded from the calculation of financial definitions and ratios. These provisions were thrown into the spotlight in 2017 after J. Crew took advantage of this flexibility in their credit agreement covenants to transfer approximately $250 million worth of intellectual property to an unrestricted subsidiary with the aim of borrowing against the transferred assets and using the proceeds to repay subordinated debt of its parent. Shutting off these 'trapdoor' provisions was a major focus for investors in 2018 with a number of loans tightening unlimited investments in restricted subsidiaries that are not loan parties and limiting the creation and usage of unrestricted subsidiaries. Investor concern over 'J.Crew'-like transactions was rekindled in June 2018 when PetSmart, Inc. announced that it had spun off a portion in Chewy, Inc. – a key subsidiary of PetSmart – to its shareholders and transferred another stake to an unrestricted subsidiary. Chewy had been a guarantor and security provider for PetSmart's secured term loan and senior bonds but such guaranty and security were released, which meant that these assets were now out of the reach of PetSmart's senior secured lenders. Although PetSmart did not rely on the same exemptions under its loan documents as J. Crew, the two transactions exemplify how covenant trends of recent years, along with generous baskets, may result in value-stripping transactions not previously contemplated by investors.

Financial covenants

The prevailing trend over the last few years toward 'cov-lite' TLB continued in 2018, with no maintenance covenant protection available to the transaction's term lenders. It should come as no surprise that the vast majority of large cap TLB deals in 2018 were 'cov-lite', but perhaps more noteworthy was that around three-quarters of non-sponsored leveraged loans were also 'cov-lite'. In the first half of 2018, the vast majority of middle market deals were also 'cov-lite', but this number dropped considerably by the fourth quarter.

Even if a traditional maintenance covenant is not included for the benefit of TLB lenders, a facility may include a 'springing' maintenance covenant for the benefit of the revolving lenders. Springing covenants are typically tested only when the relevant revolving lending facility is drawn above a certain threshold and are solely for the benefit of the revolving lenders. For large and mid-market sponsor deals, if a springing maintenance covenant was included, the vast majority 'sprung' the maintenance covenant when the revolver was drawn by more than 35% of revolving commitments. Notably, one hot button issue with respect to 'springing' maintenance covenants that has resurfaced in 2018 is how letters of credit are to be calculated in the leverage covenant. Some credit agreements provide that letters of credit that are cash collateralized will not trigger these covenants; while other agreements provide that even if these letters of credit are not cash collateralized, they will not trigger the covenant if they are below a specified dollar amount.

Debt incurrence

TLB facilities continue to allow broad flexibility to incur additional debt, whether on a first-lien, junior-lien or unsecured basis, inside or outside the credit facility and/or in the form of loans or bonds. TLB facilities typically still include more stringent parameters around the terms of secured debt than unsecured debt, including tighter limitations on the borrowing entity, final maturity, weighted average life, prepayments and, sometimes, more restrictive terms (for example, requiring a 'most favored nations' (***MFN***) provision in the case of the inclusion of a financial covenant in any *pari passu* term debt).

Broadly, there is a distinction between refinancing or replacement loans, which may be incurred within certain parameters (relating to maturity, identity of the borrower and guarantors, etc.) and additional debt (including incremental facilities), which are subject to similar parameters but also to *pro forma* compliance with a financial ratio.

Additional debt (including incremental facilities)

TLB facilities in 2018 continued the ever-widening variety of approaches to providing borrowers flexibility to incur additional debt, and most loan documents will contain more than one overlapping means by which a borrower may incur additional debt. Permitted additional debt baskets can be grouped into those that will be governed by the borrower's original credit agreement and those governed by separate documentation.

Incremental Facilities. Additional debt incurred under a particular credit agreement is typically referred to as an incremental facility. For years, TLB credit agreements have included a right to add one or more new tranches of TLB (or increase the size of an existing tranche) on a *pari passu* basis within the framework of the original credit agreement. This ability is usually subject to both (i) a restriction on the aggregate amount of new debt that can be issued, and (ii) the protection of an MFN provision that ensures any newly incurred debt will be issued with an all-in-yield of no more than a threshold amount (traditionally 50 bps, although increasingly borrowers are looking for 75 or 100 bps of headroom) in excess of the all-in-yield on the original TLB facility. The MFN provision will require the margin of the original debt to be adjusted to ensure the variance is no greater than the threshold, and as a result, MFN provisions provide further economic disincentive for a borrower considering incurring debt under an incremental facility at a higher price. For this reason, borrowers typically push for an MFN provision to expire (or 'sunset') after a certain period has passed since the initial closing.

MFN Sunset Provisions. The details of MFN provisions were again heavily negotiated in 2018. In underwritten financings, MFN sunsets remained a focus of flex provisions, even if they were seldom exercised by the arrangers, resulting in a significant number of deals with a sunset provision in 2018. The incidence of sunsets increased and the duration has varied from anywhere between six and 24 months, with the most commonly agreed period being 12 months.

Exceptions to MFN for Incremental Facilities. Some TLB facilities also incorporate other exceptions, under which the borrower may incur additional debt that is not subject to the MFN provision. These exceptions include MFN provisions which are not triggered by additional debt that has a maturity date later than the maturity date of the original term loan by an agreed period (typically more than two years). Some transactions include the right for a certain amount of incremental loans to mature earlier than the existing senior secured term loans and to be exempted from the MFN provision. Earlier maturing debt is not common in middle market or in non-sponsor deals but has gained traction in sponsor transactions. Other deals include a new basket for additional debt that is not subject to the MFN, either for the 'freebie' basket of additional debt discussed below or another agreed fixed amount and separate exceptions from the MFN where the incremental debt is being raised to finance an acquisition or other permitted investment. Finally, with an increasing number of cross-border facilities, it is becoming more common for TLB facilities to specify that the MFN will apply only to the original term loans incurred in the same currency as the new incremental facility.

Amount of Incremental Debt. The total amount of incremental debt that TLB borrowers are permitted to incur has also evolved. Size was typically determined by one or more of the following three components: (1) a 'freebie' amount that may be incurred irrespective of *pro forma* compliance with a financial ratio; (2) a ratio amount limited only by such *pro forma* compliance; and (3) an add-on amount equal to voluntary prepayments of the existing debt. While 'freebie' baskets typically are a fixed dollar amount, over half of 'freebie' baskets in large and mid-market sponsor TLB loan agreements included a 'grower' concept that set the size of the 'freebie' basket at the greater of a fixed amount and a percentage of EBITDA, providing greater flexibility to the borrower to incur debt without the limitations of *pro forma* compliance. The ratio used to determine *pro forma* compliance is a point of negotiation as well. A first lien leverage ratio (often set at first lien leverage on the closing date) is the most common, but overall secured leverage is common as well and a small number of TLB will determine the size of the ratio amount by reference to total leverage.

Incremental Equivalent Debt. In recent years, TLB facilities have also included a right to incur additional debt within the same parameters negotiated for incremental facilities under documents other than the original credit agreement that meet certain pre-agreed criteria – called 'incremental equivalent debt' or a 'side-car facility' – on the theory that the economic effect is the same as an incremental facility. Lenders typically permitted borrowers to incur incremental equivalent debt under bond offerings, but some TLB include a right to incur side-car facilities in the form of term loans. These typically do not trigger MFN protections for the incurrence, although there has been some push by investors for the MFN to apply to side-car facilities that are incurred in the form of *pari passu* secured term loans.

Reclassification. Other debt that TLB credit agreements permit a borrower to incur includes capital expenditure-related debt, acquisition-related debt and permitted ratio debt, among others, with basket sizes typically comprised of an initial 'seeded' amount plus an amount that can be incurred subject to a *pro forma* ratio compliance test. A significant number of TLB facilities now allow the borrower to reclassify debt that was initially incurred under the initial 'seeded' amount as debt incurred under the ratio amount when capacity becomes available under the ratio (a concept borrowed from high-yield bonds). These 'reclassification' provisions have been incorporated into the additional debt baskets as well as the incremental facility amount. In practice, reclassification permits a borrower to refresh the initial 'seeded' amount it can borrow without complying with the ratio tests whenever capacity under the ratio amount or another additional debt basket later becomes available. Such provisions will also now typically provide that additional debt is deemed to be incurred first under any ratio capacity before the 'seeded'/'freebie' basket in order to preserve the amount that may be borrowed without being subject to the ratio cap.

Acquisition Debt. To facilitate using incremental facilities to finance acquisitions, it is now common to allow the testing of the conditions to incurring an incremental acquisition facility (including projected compliance with any ratios and whether a default or event of default has occurred, other than a payment or insolvency default) to be tested only at the time of signing the related acquisition agreement, in order to provide the borrower (and an acquisition counterparty) with more certainty around the availability of their financing to close the acquisition. TLB facilities have not settled, however, on whether a borrower must calculate and comply with ratio thresholds while the acquisition is pending by reference to financials assuming the acquisition has not occurred, by reference to *pro forma* figures that assume closing of the acquisition or both.

Replacement debt. Typical TLB facilities provide the flexibility to borrowers to incur debt pursuant to provisions that permit refinancings, repricings, rights to 'amend and extend' outstanding loans and rights to add tranches of debt, in each case, typically subject only to the consent of the lenders participating in such debt and the agent. Each form of replacement debt is accompanied by a list of requirements regarding the form that the replacement debt may take, generally limiting the final maturity, weighted average life, and otherwise requiring that the replacement debt be on terms no more favorable to the new lenders than the old debt being refinanced.

Typically, the principal amount of replacement debt that may be incurred is limited to the actual outstanding principal amount of the debt being refinanced plus fees and expenses for the transaction. While undrawn commitments are not typically considered debt "incurred" for purposes of the additional debt restrictions until they are drawn, some recent TLB facilities now include undrawn commitments under a facility in calculating the maximum principal amount of permitted refinancing debt which can be refinanced. Since permitted refinancing debt is not subject to the *pro forma* compliance ratios that apply to additional debt, including undrawn commitments in the maximum amount of permitted refinancing debt effectively permits a borrower to incur additional debt it would otherwise have been unable to draw without complying with the *pro forma* ratio.

Other covenants and covenant exceptions

Permitted acquisitions, investments, restricted payments and junior debt prepayments

The conditions to making acquisitions, investments, restricted payments, junior debt prepayments and similarly restricted transactions continue to be borrower favorable. One typical condition to such transactions has traditionally been an absence of either (i) a continuing event of default, or, more restrictively, (ii) any event which after the giving of notice or passage of time would give rise to an event of default if not cured (i.e., a 'Default'). It has become more common for conditions to be limited to events of default only (so a restricted transaction may be permitted while a Default is continuing) and in some cases such transactions are permitted even while an event of default has occurred or is continuing so long as the event of default does not arise as a result of a non-payment or an insolvency proceeding. Conditions for permitted acquisitions and investments may also be tested upon signing of an acquisition agreement, mirroring the flexibility provided for incurring acquisition debt.

For acquisitions, borrowers are increasingly permitted to acquire entities that are not required to accede as guarantors. Similarly, it is not unusual, particularly where a borrower has significant non-U.S. operations or a non-U.S. growth strategy, for investments in subsidiaries that are non-guarantors (which most often are non-U.S. entities) to be uncapped. The borrower generally remains subject to the overriding requirement that material subsidiaries contributing an agreed percentage of the group's EBITDA (typically somewhere between 80 and 90%) must become guarantors and grant security. This will often not require controlled foreign corporations (or in some cases, all foreign subsidiaries) to become guarantors. EBITDA calculations to determine the guarantor threshold may also have specific exclusions that further reduce the number of subsidiaries that must become guarantors.

Ratio-based permissions and available amount baskets

There is no dominant approach as to which financial ratio should govern ratio-based covenant exceptions, including those for debt incurrence – first lien leverage; total secured leverage; total leverage; and a fixed charge coverage ratio are all used.

Borrowers are also now often permitted to reclassify prior transactions among dollar baskets so that they are deemed to have been permitted under another exception within a particular covenant (such as the restricted payment covenant or the investments covenants) in the same manner as discussed above with respect to debt baskets. Some TLB facilities will also permit reclassification across certain covenants, such as, for example, reclassifying a fixed dollar basket for restricted payments to be used to make a junior debt prepayment. TLB facilities rarely specify that a borrower must give notice or justify a reclassification (as reclassification is a borrowed concept from high-yield bonds, which do not require notice or explanation of reclassification).

As with the 'freebie' basket for incremental facilities, it is also typical for TLB loan agreements to provide flexibility to borrowers to undertake acquisitions, investments, restricted payments, junior debt prepayments and similarly restricted transactions that would otherwise require *pro forma* ratio compliance up to a total maximum amount. This maximum amount, called the 'Available Amount' or the 'builder basket', has traditionally been pegged to earnings which were not swept as ECF with the result that the basket's size built up over time. Now, instead of retained earnings, nearly half of large TLB facilities peg the size of the 'Available Amount' to a percentage of consolidated net income (usually 50%), which permits the borrower to build the basket faster. In addition to this performance-based component, the Available Amount will generally include an event-based component (e.g., equity issuances, debt exchanged for equity, declined proceeds from mandatory prepayments, etc.) that can be used to grow the builder basket. In 2018, some deals included asset sales proceeds that were not subject to an asset sale sweep in the event-based component of the builder baskets. Moreover, the 'Available Amount' now typically includes a fixed 'seeded' amount that is available immediately, and an increasing number of large TLB provide that the seeded amount is the greater of a fixed dollar amount and a 'grower' amount equal to a percentage of borrower's EBITDA (or sometimes total assets). Seeded amounts permit borrowers to do investments, restricted payments and other transactions from day one. Grower baskets like those that are now being used for seeded amounts remain a generally accepted TLB concept for many covenant baskets, including restricted payment baskets and often the size of these baskets is generally pegged to a percentage of EBITDA, although in non-sponsored and middle market deals it may be pegged to a percentage of total assets.

Financial definitions

The ways in which borrowers can calculate the ratios that permit additional debt incurrence have been more heavily negotiated than ever.

On the cash flow side, EBITDA definitions historically permitted borrowers to add back to EBITDA prospective cost savings from synergies arising from reorganizations and acquisitions, but such savings historically needed to be expected to be realised within a period of time (traditionally 12 months) and the amount of the add-back was capped to a percentage of total EBITDA. Borrowers have pushed for more flexibility in several ways. First, more recent definitions expand the scope of what qualifies as a reorganization transaction. Some TLB facilities now even permit add backs for expected synergies arising from any 'cost savings initiative' (i.e., not in connection with a specific acquisition or in connection with an overall reorganization plan) and leave it to borrowers to determine what initiatives qualify. Other TLB facilities permit synergies "of a type" reflected in the sponsor's related quality of earnings report (***QOE***) and, in some cases, a future QOE report. Second, the period of time within which cost savings must be expected to be realised has increased. While 12 months used to be typical, 18 and 24 months are now the new standard and in some cases the period can stretch out to 36 or 48 months or without any time limit at all. Some TLB facilities no longer require the cost savings to be expected to be realised within the agreed period but rather require only that the reorganisation or acquisition that will give rise to the expected cost savings be completed (or in some cases, committed to) within the agreed period. Finally, the cap on the amount of EBITDA add-backs has either increased (most commonly to 25% but sometimes higher) or been removed. More than 60% of large syndicated TLB facilities in 2018 permitted such add-backs without a cap, although add-backs without a cap were rarer in smaller TLB facilities, they appeared in around 43% of middle market deals. Importantly, however, there was a tightening of these uncapped deals in the second half of 2018. Where a cap is present, it will still generally apply to all add-backs over a four-quarter period as opposed to per individual transactions, which is a formulation sometimes seen in European deals.

On the debt side of the ratio, TLB facilities have for some time permitted borrowers to calculate debt net of unrestricted cash held by the borrower and its subsidiaries. Cash netting was traditionally capped to a maximum dollar amount, but the number of TLB facilities that permit cash netting without any cap has increased over time and is now present in the majority of TLB facilities.

Assignments and Amendments

Some constraints on assignments of TLB remain customary. In general, a borrower's consent to assignments (not to be unreasonably withheld) is required. However, the consent requirement falls away while certain events of default (typically limited to non-payment and insolvency) are continuing. Generally, consent will also be deemed to be given if the borrower fails to respond within a specified period. The length of such period continues to be a point of negotiation, with borrowers pushing for periods longer than the LSTA-recommended position of five business days.

Assignments to disqualified institutions (i.e. competitors and other identified institutions) are also typically prohibited. A list of disqualified institutions is typically frozen at the start of primary syndication (other than as to competitors, which can be updated over the life of the TLB). Many TLB facilities now state that the list will be provided to individual lenders upon request instead of posted generally, making it more difficult for a lender to market a loan generally to secondary purchasers who do not know whether a trade will ultimately be permitted and settle. One increasing trend in recent years has been loan investors buying debt with the intention of profiting if the loan fails to perform, either through a loan-to-own strategy or through large credit default swaps that will pay off if the borrower defaults. In response to this, 2018 saw an increasing number of borrowers looking to restrict transfers to such loan-to-own or net short investors as a general overriding rule and without naming specific institutions on the list of disqualified institutions (given the rapid emergence of new players in this space).

Finally, assignments to the borrower and its affiliates are generally permitted, although the total amount of loans that may be held by any other affiliate lenders is generally capped to an agreed percentage, typically falling around 20 to 25%, but *bona fide* debt funds of affiliates are often excluded from this cap.

The thresholds for amendments have historically been set at a simple majority of lenders. Fundamental rights (including economic rights and release of substantially all guarantees and security) require the consent of all lenders. These thresholds now typically permit partial refinancings of TLB and incurrence of additional debt with consent only from 'each affected lender' so that lenders who do not agree to participate in the change do not have any blocking right. In practice, some amendments (e.g. the release of all or substantially all guarantees and/or collateral) will still require unanimous consent. Agents are typically permitted, however, to agree to consequential amendments (such as those to security documentation) that implement permitted additional or replacement debt without any further lender consent. Notably, in 2018, there was a heightened focus by lenders on the consent necessary to amend *pro rata* sharing provisions in light of certain recent deals including, but not limited to, NYDJ Apparel.

Conclusion

Despite an overall strong year for the U.S. leverage finance market, it remains to be seen how long the current cycle can last. Will TLB covenant packages continue to erode in favor of increasing bond-like flexibility or will they revert to something closer to the traditional model requiring de-levering and consistent engagement with lenders?

The underperformance and volatility in the second half of 2018 remains on every market participant's mind. Whether the market remains volatile will depend, at least in part, on the macroeconomic and geopolitical landscape in 2019, including any future developments relating to the U.S.-China trade war and expectations around future interest rates. If the trend continues into 2019, there is an expectation that borrower-friendly provisions (such as MFN carve-outs in incremental facilities) will receive push back from investors. However, it is not all doom and gloom. Some market watchers see signs of optimism in the leveraged loan space. Of note, they point to large amounts of capital raised by private equity in 2018 that will need to be invested and a robust pipeline of M&A deals many of which will require financing. For all these reasons, investors are in wait-and-see mode and how the year plays out is something we will all be watching closely.

Endnote

1. In particular, a Section 956 deemed dividend could still occur if the non-US subsidiary earned US source income, or if the parent did not satisfy the one year holding requirement necessary for the participation exemption.

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Chapter 13

The Continued Growth of European Covenant Lite


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In 2018, global sponsors and their advisers continued the trend of successfully exporting their experiences from financing transactions in the US leveraged loan and global bond markets to the European leveraged loan market. Momentum behind the continued adoption of US covenant-lite terms into European loans remains strong as there is now a significant source of European "cov-lite" precedents, in turn strengthening the argument for cov-lite, in the absence of a market correction. Investors were, however, more successful on pushing back on certain pricing and documentation terms during 2018. This convergence brings a number of documentation issues to consider.

Covenant-lite Loans

In a covenant-lite loan, either there is no financial maintenance covenant or there is a single financial covenant solely for the benefit of the lenders under the revolving credit facility with no financial maintenance covenant for the term lenders. The covenant benefitting the revolving lenders typically is a "springing" covenant, i.e., tested only if the revolver is drawn as of the end of a fiscal quarter and such usage exceeds a certain percentage of the revolving credit commitments, often 35–40%, with the applicable levels set with significant EBITDA "cushion" or "headroom" of around 30% or more and no or very few step downs. The nature of drawings counting within the trigger is also narrowing to exclude all non-cash utilisations (and sometimes all ancillary facilities).

Associated provisions customary in US covenant-lite structures are regularly being adopted in Europe. For example, the US-style equity cure, with cure amounts being added to EBITDA and no requirement for debt pay-down, is now being accepted by many lenders in Europe on cov-lite deals. Interestingly, the European market generally permits over-cures, whereas the US market limits cure amounts to the maximum amount needed to ensure covenant compliance. It is common in both the US and Europe to have a cap on the number of permitted cures – most commonly limited to two quarters in any period of four consecutive quarters and a total of five cures over the life of the loan.

Documentation

In the past there was a "battle of the forms" in relation to documenting European covenant-lite loans, with the first cov-lite loans emerging in Europe in 2013 being documented under New York law. The next generation were governed by LMA-based credit agreements, stripped of most financial covenants and otherwise modified in certain respects to reflect "looser" US practice on terms for cov-lite deals. We now have LMA-based loan agreements that in addition to the absence of financial covenants for the term loan adopt more wholesale changes based on US market practice, primarily in that they introduce leverage or coverage-based incurrence style ratio baskets rather than traditional loan market baskets fixed at a capped amount. A number of the other features of current cov-lite European leveraged loans are considered below.

Increased Debt Baskets

Limitations on borrowings often have US-style characteristics, so rather than a traditional debt basket with a fixed capped amount, we now see permitted debt limited solely by a net leverage or secured leverage test with a fixed capped ("freebie") basket alongside (with that basket often being a soft "grower" basket). Occasionally, unsecured debt is permitted up to a 2× interest coverage test (a concept imported from the high-yield bond market). This debt can be raised through an incremental "accordion" feature and increasingly separate "sidecar" financings. This style of covenant leads to far greater flexibility for a borrower to raise additional debt as pari secured, junior secured, unsecured or subordinated loans or bonds. In some financings, reclassification is permitted so that the "freebie" basket can be used if the ratio basket is unavailable, and then subsequently moved into the ratio basket once the ratio is met, thus freeing up the "freebie" basket. The net effect of these provisions is to allow borrowers to continually re-lever up to closing leverage plus the amount of the "freebie" basket, which itself often allows for up to another turn of leverage to be incurred. The MFN protection relating to new incremental loans continues to be a focus of negotiation, both as to sunsets (after 6 or 12 months) and other carve outs of debt structures (e.g. side cars; acquisition debt).

Builder Baskets

Another trend from the US cov-lite loan market (which is also a feature of the high-yield bond market) that is being adopted in European loan deals is a "restricted payments builder basket", where the borrower is given "credit" as certain items "build up" to create dividend capacity, starting with the borrower's retained portion of excess cashflow ("ECF"), IPO and other equity proceeds, and unswept asset sale proceeds, usually subject to a net leverage ratio governor as a condition to usage. In some cases there may be no limit to distributions if a lower leverage ratio test is met. There is an increasing trend towards an even more aggressive variant based more closely on the high-yield bond formulation, which credits a percentage of consolidated net income ("CNI") (usually 50%) rather than retained excess cashflow, with the disadvantage for lenders in that CNI is not reduced by the deductions used to calculate ECF and because the build-up may begin for years prior to the onset of the ECF sweep. The builder baskets may also have additional "starter amounts", some soft capped by reference to EBITDA.

US-style Events of Default

US-style events of default continue to be resisted by European loan syndicates, but we have seen more loan financings that include defaults more akin to the US loan approach, e.g.: removal of material adverse change default; no audit qualification default; or even the high-yield bond approach (more limited defaults, including cross acceleration rather than cross default, with longer remedy periods, which regarding bankruptcy defaults is unusual in Europe).

Other Provisions

There are other provisions we have seen migrate from the US cov-lite (or high-yield) market to Europe (or otherwise evolve within the European market) to become well-established, including:

- "Permitted Acquisitions" controlled by a leverage test (or no test at all) rather than by imposing absolute limits – and generally fewer controls on acquisitions.
- "Permitted Disposals" similarly trending towards a high-yield formulation that does not impose a cap and has varying requirements for reinvestment/prepayment and cash consideration.
- Guarantor coverage ratios are trending towards an EBITDA test only (at 80–85%).
- Change of control mandatory prepayment being adjusted to allow individual lenders to waive repayment (becoming effectively a put right).
- Increased use of general "baskets" (as distinct from and in addition to ratio-based incurrence tests) with a soft dollar cap that increases as total assets or EBITDA grows.
- Provisions that state that if FX rates result in a basket being exceeded, this will not in and of itself constitute a breach of the debt covenant (or other limitation).
- Use of the concept of a "Restricted Group" and ability to designate subsidiaries as "Unrestricted" and therefore outside the representations and covenants.
- A small number of financings have EBITDA addbacks (as used in financial ratios for debt incurrence purposes) which are uncapped.
- An increasing trend for Majority Lenders to be set at 50% rather than the traditional European percentage of 66⅔% (sometimes with the lower percentage used for consents and the higher percentage for calculation).
- Greater restrictions on transfers to competitors and "loan to own" funds, with more limited default fall aways (e.g. payment and insolvency only).

Economic Adjustments

Economic adjustments such as a 101% (or 100.50%) soft call for six months, a EURIBOR floor, and nominal (0.25%) quarterly amortisation are also often introduced to make loans more familiar to US loan market participants.

Structural Consequences – the Intercreditor Agreement Revisited

Adopting products from other jurisdictions brings with it the risk of unintended consequences. US terms and market practice have developed over decades against a background of the US bankruptcy rules and US principles of commercial law. The wholesale adoption of US terms without adjustment to fit Europe's multiple jurisdictions can lead to a number of unintended consequences.

A good example of this relates to European intercreditor agreements, which have over time developed to include standstills on debt claims and release provisions. At heart is the continuing concern that insolvency processes in Europe still, potentially, destroy value. Although significant steps have been taken in many jurisdictions to introduce more restructuring friendly and rescue-driven laws, it remains the case that in Europe there is a far greater sensitivity to the ability creditors may have in times of financial difficulty to force an insolvency filing by virtue of putting pressure on boards of directors through the threat of directors' liability under local laws. A significant feature of the restructuring market in Europe for many years has been the use of related techniques that creditors, particularly distressed buyers, adopt to get a seat at the table by threatening to accelerate their debt claims. Standstill provisions evolved to prevent creditors from using this type of action to disrupt a restructuring without having to resort to a bankruptcy proceeding to provide a stay and thereby obtain increased recoveries.

Another intercreditor provision of great focus over the years has been the release provision, which provides that in the case of distressed asset sales following default and acceleration, the lenders' debt and guarantee claims against, and security from, the companies sold are released. In some deals from the last decade, these protective provisions had not been included, with the result that junior creditors could gain significant negotiating leverage because their approval was needed for the release of their claims and security, without which it is not possible to maximise value in the sale of a business as a going concern.

The potentially significant debt baskets referred to above become relevant in this context. In the US, where this flexibility originated, debt baskets do not legislate as to where in the group debt can be raised – structural subordination does not often play a significant role in a US bankruptcy because typically the entire group would go into Chapter 11. In Europe, structural subordination can have a dramatic effect on recoveries (as suffered by the first wave of European high-yield bonds in the 1990s, which were structurally subordinated). Even if those subsidiaries have granted upstream guarantees, the value of the claims under such guarantees are often of limited value.

Until recently, most provisions allowing the incurrence of third-party debt did not require the debt providers to sign up to the intercreditor agreement unless they were sharing in the security package. With more flexibility to incur third-party debt, it is very possible that an unsecured creditor under a debt basket can have a very strong negotiating position if the senior secured creditors are trying to sell the business in an enforcement scenario, given the lack of standstill and release provisions. We are therefore seeing a continuing trend that third-party debt (including unsecured debt) over a materiality threshold is required to become subject to the main intercreditor agreement (and, therefore, the critical release provisions described above). It is of note that while this is becoming a trend in loan transactions, it is not structured for in European bond transactions.

These provisions become even more important to structure appropriately given the new trend is to seek to adopt "lifetime" intercreditor agreements which remain in place for future debt structures.

What Does This Mean for 2019?

It seems likely that low interest rates may continue to prevail in the Eurozone, and the depth of the investor base looking for yield will continue to permit significant flexibility in covenant and documentation issues. The trend of greater investor push back on certain deals is likely to continue. Experience suggests that it is only where a particular credit generates surprising losses upon a default that there is any significant resetting of market terms.

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Cross-Border Loans – What You Need to Know

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Part I – Trends in Cross-Border Loans

What do we mean by cross-border loan?

In this article, the term "cross-border loan" refers to two broad categories of syndicated loans. The first category covers loans issued by non-US borrowers in the US institutional term loan B market and the second category covers loans issued by US borrowers in the European institutional term loan B market. Cross-border loans emerged as far back as the early 2010s and were for a long time limited to US-dollar denominated term loans extended to non-US borrowers that were syndicated in, and included terms typical for, the US term loan B market. Until late 2016, these loans were based predominantly on **New York law**-governed credit documentation and were dubbed "Yankee loans". As the European term loan B market experienced strong growth in 2017 and 2018, however, some of these US-dollar loans were based on **English law**-governed credit documentation and syndicated in either the European or US institutional term loan markets. (For a detailed history of Yankee loans and the gradual adoption of US-style loan terms in the European market, see our previous articles on this topic in *The International Comparative Legal Guide to Lending and Secured Finance* for 2018 and 2017.)

As a result of the growth of the European institutional term loan B market, institutional investors in this market have gradually become more accustomed to US-style loan covenant packages and terms (which themselves have become much more closely aligned with unsecured high yield bond incurrence-based covenant packages and terms) that were previously only seen in the US market. The increasing convergence of terms between the US and European markets has led to a hybrid approach of market terms that are now common in both US and English law credit documentation. Given this shift, more US borrowers with foreign operations have migrated their loan issuance over the past two years to European markets. As we enter 2019, the result is a cross-border loan market where issuers tap markets across the Atlantic, in both directions.

As a general matter, cross-border loans have still not become prevalent with borrowers from Asia (i.e., Asian borrowers seeking financing in the US or Europe). For these borrowers, a combination of continued high levels of liquidity available from local lenders (mainly strong domestic banks in each of the key markets in the region and regional asset management companies as well as the local branches of major international commercial and investment banks) and challenging legal and regulatory regimes in many of the local markets, makes local pricing too competitive and structures too challenging for the international institutional term loan markets. For many borrowers in Asia, the arbitrage on covenant and terms flexibility offered by the international institutional term loan markets has not been enough to overcome this pricing differential in most local markets. This is exacerbated by the fact that, increasingly, international financial sponsors have been able to negotiate many of the "bells and whistles" on covenant packages and terms flexibility that would be available in the US or European term loan B markets in certain local transactions.

In contrast to the position in Asia, Australian borrowers, initially in 2014/5 and again more recently in 2018, have been attracted by the US institutional term loan B market. In addition, it is in this market where we have seen unitranche and domestic TLB facilities, which follow US and European unitranche and TLB terms, gaining popularity, with local offices of international credit funds and international investment banks being the most active providers of financing under these structures.

Cross-border loan trends in 2017 and 2018

Cross-border loans globally experienced a significant uptick in 2017 over 2016 from around $70 billion to a volume around $110 billion, setting a record high. In the US market alone, cross-border loans set a record high of $68 billion and European market cross-border loan issuance jumped from $22 billion in 2016 to $42 billion in 2017.[i] While this increase in cross-border activity was commensurate with the increase in overall lending volumes in 2017, nonetheless the prevalence of these cross-border loan issuances during that period underscores the relative persistence of this type of loan product. In 2018, cross-border loans in the US market experienced a small decrease to $61 billion but the European market held steady at $43 billion.[ii] These trends indicate that global companies issuing term loan B debt continue to be comfortable syndicating in both markets and that this phenomenon is here to stay.

Many of the more flexible terms that are prevalent in current term loan B facilities originated in the US unsecured high yield bond market. Originally, this began in the US as a practice of aligning the covenant packages of term loan B facilities with simultaneously issued unsecured high yield bonds of the same issuer. However, the trend has continued to the point that investors accept such terms in deals where the capital structure does not include high yield bonds. The US leveraged loan market was quicker to adopt this approach, but now, it is relatively common for both US and European leveraged loan B deals to include high yield style incurrence-based covenant packages even when these facilities are being issued independent of a side-by-side unsecured high yield bond issuance.

The rapid evolution in terms was driven in large part by an imbalance across markets between supply and demand, giving rise to some of the most borrower-friendly terms that have been seen in international debt capital markets since the LBO boom that preceded the financial crisis of 2007 and 2008.

As part of the change in European deal terms in 2017, there was a substantial increase in the volume of covenant-lite European term loan B issuance. Continuing through 2018, although there was a small decrease in covenant lite deals done in Europe, such deals have maintained pace with the amount of covenant lite deals that are done in the US as a percentage basis of overall deals in each relevant market (around 85% in each market).[iii] Prior to the broad emergence of covenant lite deals in Europe, European leveraged loans were structured with a suite of four maintenance financial covenants testing leverage, interest cover, cashflow cover and capex spend, followed in more recent times by a trend towards more "covenant-loose" deals (which include only leverage and interest cover protection). Considering the fact that there were hardly any European covenant-lite deals between 2008 and 2011, the increase has been substantial over time and is arguably one of the most significant changes to deal structures in the last decade.

In a covenant-lite deal, term loans do not benefit from any maintenance financial covenant. Only the revolving facility benefits from a single maintenance financial covenant, normally a leverage-based ratio test (and this only applies on a "springing" basis – at the end of a fiscal quarter, only if revolving utilisation exceeds a certain percentage of revolving capacity on such date, typically ranging between 30 and 40% of revolving capacity).

More importantly, the negative covenant package for "covenant-lite" loan facilities is either fully or partially incurrence-based in nature, similar to what would historically be found in a US unsecured high yield bond covenant package.

In addition to the European market's adoption of some greater covenant flexibility historically more common in US deals, new trends relating to the convergence of the two markets have emerged recently. In some instances, European deals have retained New York as the governing law for, or the law used to interpret, covenants, defaults and certain related definitional constructs that have been incorporated from the US market. Some specific covenant exceptions that became further embedded in the European market in 2018 include an exception for contribution debt (i.e., ability to incur debt up to the amount of equity contributed to the borrower after the closing date, and sometimes a 2× multiple of that amount), an increased ability to use an EBITDA-based grower basket for the fixed or "freebie" component of the "available amount" basket, more flexibility to conduct permitted acquisitions, and an uncapped ability to sell assets (subject to the US-style 75% cash consideration requirement). About half of all European deals in 2018 also adopted the US approach to majority voting requiring only 50.1% of lenders to consent to an action instead of a 66⅔% super majority which was the historical norm.[iv] In contrast, only 17% of European deals accepted the simple majority approach in 2017. European lenders are also being further restricted in their ability to assign loans without borrower consent, as some English law-governed credit agreements in 2018 incorporated the US-style disqualified lender concept in addition to the already stringent "white list" concept that has been the longstanding market standard in European deals.

When it comes to European terms migrating to the US market, some notable instances include the expansion of the MFN pricing cushion for incremental debt and some of the more borrower-friendly equity cure provisions. Historically, the MFN cushion in the US market was set at 50 basis points. The European market began to expand this to 75 or even 100 basis points beginning in 2016 and this year the US market saw an increasing number of deals with a 75 basis point differential. European deals have also been split as to whether MFN should be measured based on margin or the more lender-protective all-in-yield standard. Though with only some success, some strong sponsors in the US market have started pushing for the more liberal margin standard since the beginning of 2017. With respect to equity cure rights, while EBITDA-based cures that originated in the US market have now become embedded in the European market, European trends such as deemed cures when non-compliance is remedied in subsequent quarters or the ability to cure a default by reducing revolving facility borrowings below the "springing" trigger level, have seeped into some US deals.

Not all convergence has moved in favour of Borrowers, though. For example, the European market did not historically require call protection on first-lien term loan B facilities but have, in recent years, adopted the US market convention for call protection, typically set at 101% for six months. Though this trend may have begun before the more significant convergence of market terms that has occurred since 2017, European deals with this type of call protection jumped from 60% in 2016 to 90% in 2018.

Overall, the fact that the European market has broadly adopted more borrower-friendly terms from the US market indicates that – barring any significant liquidity crunches in either market – terms between the two markets may eventually reach a general equilibrium and consistency. Although standardisation of documentation in the leveraged loan markets has always been, and remains, an elusive reality, substantive convergence of terms does have its benefits to both issuers and institutional investor lenders, alike. To the extent that, substantively, covenant packages in the US and European markets remain closely linked, loan investors may have an easier time with investment decisions and issuers can more readily take advantage of structural or pricing considerations to shift between the two markets.

Outlook for 2019

Whether the volume of cross-border loans will hold steady in 2019 or fluctuate is hard to predict. On the one hand, US borrowers, especially those with significant overseas operations, will continue to be attracted to the European market if it continues to demonstrate a willingness to provide covenant flexibility that was previously only found in the US market and better pricing as compared to the US market. Changes to the US tax code introduced by the 2018 Tax Cuts and Jobs Act may also drive some multinational companies to utilise more non-US borrowing capacity to mitigate the effect of the new cap on interest deductibility introduced by these reforms.

On the flip side, political uncertainties, including the looming conclusion of the Brexit saga, may impact the European markets in ways that are still unclear and which may deter US borrowers from crossing the Atlantic. In the run up to Brexit, many English law-governed credit agreements included a carveout from gross-up/increased cost provisions for costs and/or losses related to Brexit. We can expect these provisions to continue to be prevalent in these facilities and to become more precise once a definitive path with respect to Brexit is finalised.

As US and European debt capital markets continue to evolve and mature, it can be expected that credit documentation in different loan markets will continue to be impacted and that further convergence of terms between the US and European term loan B markets in particular, and between the bank and bond markets more generally, is likely to occur. The continuing globalisation of the private equity and leveraged finance markets in 2019 and beyond will increasingly result in pressure for terms that become customary in one region to be adopted quickly in other regions. Lenders will need to consider carefully whether it is appropriate in all cases to import terms accepted in one region into deals featuring borrowers and guarantors in different regions (as a "one size fits all" approach may well not be appropriate in all circumstances). Even if arrangers find that progressive terms in one market may be accepted in the other market as an initial matter, careful consideration should be given whether those terms may result in blind spots that only become noticeable when the markets contract.

Part II – Structuring Cross-Border Loans – Considering the Location of the Borrower and Guarantors

Notwithstanding the ongoing convergence of terms between the US and European markets, there remain numerous and varying considerations that must be explored when dealing with cross-border loans. That is to say, while key covenant and even some payment terms may have become generally consistent in both markets, and may continue to do so, cross-border loan issuers and investors still must undertake an important exercise in terms of analysing the capital structure, covenant package and form of documentation depending on where the relevant credit support and value sits. And, while obvious factors such as pricing, currency needs and tax implications will most certainly play a key factor in the decision-making process of whether a syndication will be conducted in the US or European loan markets and the choice of governing law and style of the loan documentation (i.e., US style *vs*. UK/LMA style), set forth below are numerous additional considerations, including some that have only recently become relevant, that should impact underwriters', issuers' and loan investors' views with respect to structuring these loans.

Comparing guarantees and security in different jurisdictions

US and Canadian credit parties

The value of security and guarantees from borrowers and guarantors located in the US in secured loan transactions is generally not a source of material concern for senior secured lenders. The UCC provides for a relatively simple and inexpensive means of taking security over substantially all of the personal property of a US entity and taking security over real estate assets is, generally, relatively straightforward and inexpensive. Furthermore, save for well understood fraudulent conveyance risks, upstream, cross-stream and downstream guarantees from US entities do not give rise to material value leakage concerns for senior secured lenders. A similar position applies in Canada.

US-style vs. European Style Guarantee and Collateral Provisions

Historically, US borrowers have been limited in their ability to obtain guarantee and collateral support from certain non-US subsidiaries that are "controlled foreign corporations" (commonly referred to as "CFCs") due to the operation of Section 956 of the Internal Revenue Code. The tax code treats support provided by CFCs as a "deemed dividend" which, absent actual distribution of cash from such CFCs would trigger unwanted US tax liabilities for the credit group. To avoid triggering the deemed dividend, US deals have historically been structured to exclude any guarantees by CFCs and collateral was limited to a 66% pledge of the CFC's voting stock (a safe harbor under the tax code). The result was that in most US deals, usually involving a US borrower or US parent company subject to these "deemed dividend" rules, the direct credit support was limited to US domestic subsidiaries and their assets while the value of foreign operations was excluded from the credit package (save for the 66% equity pledge of the stock of first-tier foreign subsidiaries).

In contrast, in most European deals, where usually the US tax code and the negative consequence of a "deemed dividend" is not applicable, the guarantor and collateral package (subject to the limitations noted below) could broadly cover all of the jurisdictions in which the borrowing company operates. Often, borrowers and their advisors conduct an analysis to identify the jurisdictions where it is legally feasible to provide credit support and where there is the most value (as a percentage of total assets, total revenues and/or EBITDA) to devise an agreed set of covered jurisdictions. The deal documentation will then provide for a guarantor coverage test that usually seeks to ensure that at all times a certain percentage of the total assets/EBITDA of the credit group provides direct credit support via guarantees and collateral pledges (typically this is set at 80% in European deals, but the percentage can be lower in some top-tier sponsor deals). So, without the "deemed dividend" limitations, lenders in European deals have historically been able to achieve greater levels of direct credit support from companies with global operations.

When the US congress passed the Tax Cuts and Jobs Act in late 2017, it left Section 956 intact, but it separately provided a deduction for actual dividends received by a US shareholder from its non-US subsidiary, effectively making such income exempt from US taxes. The result was an odd disconnect between treatment of actual dividends (exempt from taxes) and deemed dividends (subject to tax liability) from non-US subsidiaries.

To remedy this inconsistency, the IRS proposed regulations on October 31, 2018[v] that would reduce the tax liability associated with deemed dividends as if it had been an actual dividend, effectively removing the negative tax consequences of such deemed dividends. Once the regulations are adopted by the Treasury Department (and even before that, as the regulation permits taxpayers to rely on the new rules prior to their finalisation), borrowers will have more flexibility to provide greater guarantee and collateral support from non-US subsidiaries.

While this new tax treatment of CFCs has been available for some time, the US loan market has not seen an increase in the number of deals where CFCs provide guarantees and collateral. Indeed, in many sponsor-backed deals, guarantees and collateral of all non-US entities continue to be excluded via broad carveouts from the credit support package. In many instances, this is true even when the relative value (based on a total assets and EBITDA generation) of foreign operations is meaningful. Time will tell whether the emergence of this change permits further convergence of US and European deals such that US deals can also now incorporate a guarantor coverage test and capture value of significant overseas operations in the guarantee and collateral package.

Though these changes to the US tax regime present lenders with a new opportunity for additional credit support, in structuring non-US credit support lenders must still consider other factors that may limit a non-US subsidiary's ability to provide support. Specifically, local regulations may prevent the non-US subsidiary from providing financial assistance in an acquisition financing context or place liability on the directors approving such credit support. Upstream credit support can also be impacted by varying corporate benefit regimes in non-US jurisdictions so caution must be used in structuring credit support from non-US subsidiaries. Finally, local tax specialists in each non-US jurisdiction should always be consulted to confirm the impact of guarantees and collateral provided by entities in those jurisdictions.

Considering the applicable insolvency regime

When structuring cross-border loans, an essential element that must be considered is the insolvency regime that is likely to apply in an enforcement scenario. Whereas the US benefits from Chapter 11 and the UK has developed the court-approved scheme of arrangement to deal with restructurings, the applicable restructuring regimes in other jurisdictions are considerably less uniform, codified and comprehensive. It remains to be seen whether changes introduced in other jurisdictions over the past few years will significantly improve the position of senior secured lenders to credit groups with borrowers or guarantors organised, or with significant assets located, in those jurisdictions.

Thoughtful consideration of the applicable insolvency rules is especially important given the prevalence of US-style covenant terms that are now incorporated in non-US credit agreements with loan parties that are predominantly located in non-US jurisdictions. US-style incurrence-based covenant terms were developed, and gained acceptance, in a market where the issuers of the debt benefiting from those terms would likely be subject to a US law-governed Chapter 11 restructuring, which meant lenders could rely on a presumption that US Chapter 11 principles, protections and processes would dictate the outcome of any restructuring. With less uncertainty about what would happen in a restructuring, US institutional lenders were early adopters of terms that gave borrowers greater covenant flexibility. When the borrower and guarantors are primarily non-US entities that may not benefit from a set of uniform restructuring rules like Chapter 11, the flexibility permitted by such covenant packages (in particular in regard to incurring additional debt, making future investments and acquisitions and certain intercompany transactions) may not be adequate to preserve the senior secured status of any term loan B tranche (and any *pari passu* revolving facility). The dramatic increase in flexibility included in European credit documentation over the past two years is somewhat surprising in light of this consideration. Thus, an accurate and complete understanding of the insolvency laws in the jurisdiction and the location of the borrower(s) and the guarantor(s) of the senior secured debt is of paramount importance.

By gaining an understanding of what insolvency regime may apply to a given credit group, senior secured lenders can better assess the likelihood of repayment in a default or restructuring scenario. This is generally achieved by ensuring that the applicable rules will allow the senior secured lenders to sit at the top of any liquidation or proceeds waterfall. A critical element to achieving this result and, thus a greater recovery, is the importance of arming the senior secured class of creditors with tight controls over any restructuring process, and the mechanisms for doing this are unique to where the debtor is located.

United States Chapter 11

In the US, a typical in-court restructuring in a leveraged finance transaction is usually accomplished through a Chapter 11 case under the US Bankruptcy Code. Chapter 11 rules allow, in certain circumstances, senior secured lenders to cram down "out of the money" junior secured or unsecured creditors and release the related debt claims, guarantee claims and security pursuant to a Bankruptcy Court-approved plan of reorganisation.

A Chapter 11 restructuring is an in-court process where the primary aim is to allow a business to restructure its operations and capital and emerge out of bankruptcy as a going concern. Approved Chapter 11 plans are binding on all creditors of a debtor (or group of debtors). Prior to a Chapter 11 plan being approved, an automatic stay applies (with global effect) that prohibits any creditor, including trade creditors and suppliers, from taking enforcement action which could diminish the value of the business.

Europe and Asia – Out-of-court process

By contrast, in Europe and Asia, it is more usual for a restructuring in a leveraged finance transaction to be accomplished through an out-of-court process. Most commonly, this is achieved through enforcement of share pledge security in order to transfer ownership of the top holding company of the credit group and effect a sale of the business as a going concern.

One of the key reasons for this is that placing a company into local insolvency proceedings in many European and Asian jurisdictions is viewed very negatively – quite often only as the option of last resort. Suppliers and customers typically conceive of local proceedings as a precursor to the corporate collapse of the business since often there is no Chapter 11-equivalent restructuring process available in the applicable European or Asian jurisdiction that would allow for re-emergence as a going concern. The result is that entering into local insolvency proceedings can be value-destructive (in particular because of the lack of an automatic stay that binds trade creditors and suppliers and, in some cases, because of a lack of clear procedures for cramming down junior creditors).

Europe and Asia – an alternative – the English court-based scheme of arrangement

As an alternative to an out-of-court process, creditors in Europe and Asia who document their transactions under English law may be able to take advantage of a scheme of arrangement – a statutory procedure under the UK Companies Act which allows a company to enter into compromises and arrangements with its creditors, with those compromises and arrangements then being sanctioned by an English court.

Notwithstanding that a European- or Asian-centric transaction may have no substantive nexus to England, the scheme of arrangement option may still be available, as the English courts have determined that a sufficient connection will exist to enable them to sanction a scheme of arrangement so long as a primary finance document contains an English choice of law and exclusive jurisdiction clause.

The primary aim of a scheme of arrangement is to allow an arrangement or compromise in respect of debt claims of a (solvent or insolvent) company to be made, and to be binding on all creditors, if the scheme is agreed by a majority in number and 75% by value of all creditors (or each class of creditors) including secured creditors. This approach effectively enables a "cram-down" of minority creditors in a similar manner that Chapter 11 would in the US even if the other benefits of a Chapter 11 proceeding (e.g., the automatic stay) may not be present. However, it should be noted that the English courts may use their discretion to grant a stay on action by creditors on a case-by-case basis if the court considers, among other things, that the scheme of arrangement is reasonably likely to succeed.

The role of the intercreditor agreement in out-of-court processes

In order for senior secured lenders in non-US markets to retain control of an out-of-court restructuring process (in situations where it is not possible to rely on a Chapter 11 process, an English scheme of arrangement or any other similar local insolvency in-court process), they have traditionally relied on contractual tools contained in a European-style intercreditor agreement, with specifically tailored provisions relating to enforcement standstills and release provisions.

An enforcement standstill operates to limit or prohibit junior creditors from taking any enforcement action, including taking any steps to accelerate their debt claim or to enforce (or instruct the security agent to enforce) the transaction security. Standstills are designed to prevent junior creditors from obtaining leverage by threatening to force borrowers or guarantors into a value-destroying local insolvency proceeding and to allow the senior secured lenders time to implement a controlled disposal of the credit group through enforcement of their own, higher ranking, transaction security.

Release provisions apply upon a "distressed" disposal of the credit group, i.e. a disposal following an acceleration event or when transaction security has otherwise become enforceable. The release provisions allow senior secured lenders to sell a business free of the claims of junior creditors that are party to the intercreditor agreement. Such release provisions provide that all of the borrowing and guarantee liabilities of, and the security granted by, the borrower or guarantor being sold (together with the borrowing and guarantee liabilities of, and the security granted by, any of its subsidiaries) will be released upon a distressed disposal.

Because the release provisions give senior secured lenders the right to eliminate the debt claims of junior creditors, so called "fair value protections" are typically included to give junior creditors some degree of comfort that the enforcing senior secured lenders will sell the business for a "fair price" on arm's length terms. This "fair value protection" is a contractual attempt to provide comfort similar to that obtained through the judicial oversight afforded in a Chapter 11 or scheme of arrangement in-court process.

Automatic acceleration

One final note with regard to insolvency laws – the US Bankruptcy Code does not permit creditors to take any action against a debtor in a US bankruptcy case to collect outstanding obligations after that debtor files for US bankruptcy, including taking actions against any collateral or to accelerate the maturity of the loans. Since most guarantees provide that the guarantor is obligated to pay the guaranteed debt "when due", it is necessary that such debt be accelerated for a guarantee to be fully called upon prior to the final scheduled maturity of the guaranteed debt. The automatic acceleration provision is crucial, therefore, since it removes any doubt as to whether the loans have been accelerated and does so without violating the automatic stay applicable to the debtor (by avoiding the need for service of any acceleration notice), thereby enabling lenders to call on any guarantees of non-bankrupt guarantors and crystallise their claims against any bankrupt guarantors. However, including a US-style automatic acceleration provision, whilst an important structural feature in a domestic US deal (due to the automatic stay applicable upon a US bankruptcy filing), may not result in the right outcome in the context of a non-US credit group. Such a provision could force certain non-US borrowers and guarantors into a local insolvency process which may be value-destructive and may derail the manner in which a senior secured creditor is trying to organise and control a restructuring process. Careful thought should therefore be given as to which non-US borrowers and guarantors are subject to automatic acceleration provisions (taking into account the fact that certain non-US entities can easily file for US bankruptcy protection).

Other considerations based on the location of borrowers and guarantors

In US secured loan transactions, the borrower could be organised in any state of the US without giving rise to material concerns for senior secured lenders based solely on jurisdictional considerations. In Europe, however, there are a number of considerations which are of material importance to senior secured lenders when evaluating in which European jurisdiction a borrower should be organised and the quality and value of credit support that will be available from its subsidiaries and affiliates.

Lender licensing rules

Many European jurisdictions impose regulatory licensing requirements for lenders providing loans to borrowers organised in that particular jurisdiction (which is not a consideration that generally causes concern in US deals).

Withholding tax on interest payments

Withholding tax may be payable in respect of payments made by borrowers organised in many European jurisdictions to lenders located outside of the same jurisdiction (in particular, many "offshore" US term loan B investors are unable to lend directly to borrowers located in certain European jurisdictions without triggering withholding tax or interest deductibility issues). In addition, some European jurisdictions may impose limits on the number of creditors of a particular nature that a borrower organised in that jurisdiction may have without triggering additional withholding tax obligations.

Foreign debt restrictions

In certain jurisdictions in Asia and Latin America, there are restrictions prohibiting or limiting local borrowers from issuing foreign debt (i.e. debt that is either provided by a non-resident lender or that is not denominated in the borrower's local currency).

Foreign exchange restrictions

In certain jurisdictions in Asia and Latin America, foreign currency exchange rules mean that there are limitations – or in some cases, prohibitions – on expatriating cash and, to add to the complexity, these rules in some cases can be vague, untested and subject to frequent and unpredictable change.

Part III – Documenting Cross-Border Loans – Considerations Regarding the Different Terms and Practices in US and European Leveraged Loan Markets

While, as noted above, the US and European loan markets have experienced much broader convergence of terms in the last two to three years, the two markets still operate differently in many practical ways and remain subject to separate and differing sets of rules and regulations. The following is a non-exhaustive list of some key areas for all market participants to be aware of when negotiating either **New York** law or **English** law credit documentation.

Value leakage and debt incurrence

Lenders in any financing should be concerned if credit parties are able to move value outside of the credit group, whether it is via a removal of valuable assets from the collateral package or through the exclusion of valuable subsidiaries from the guaranty requirement. Such value leakage is amplified greatly if such subsidiaries are then permitted to incur additional debt which may even be supported by the very assets that were just removed from the collateral package.

European and US loan markets have historically prevented such value leakage in two important and distinct ways. The US market historically capped the amount of assets or investments that could flow from loan parties (i.e., the borrower and its subsidiaries that are guaranteeing the loan) to subsidiaries that are not loan parties. This cap also served to limit the acquisition of subsidiaries that do not become loan parties.

European deals relied on the guarantor coverage test discussed above to prevent leakage or, in other words, companies were permitted to move assets around freely so long as the subsidiaries guaranteeing the loans represented at least 80% of consolidated EBITDA and total assets.

Both of these approaches are far more restrictive than the high yield bond market where investments between "restricted" subsidiaries (i.e., those subsidiaries that are restricted by the covenants) are freely permitted. This makes sense given that the high yield bonds have typically been unsecured, so the bondholders are in no worse position if assets are moved throughout the structure.

While free transferability of value from credit parties (i.e., issuers and guarantors) into non-guarantor restricted subsidiaries results in a loss of direct credit support with respect to the value invested, that value can still be captured residually through guarantees provided by parent entities that are themselves direct obligors. But, that is only the case if there is no structurally senior debt incurred directly by the non-guarantor restricted subsidiary. Such debt would have a direct claim at an entity with respect to which the bondholders do not and therefore all the value of that subsidiary would accrue to the benefit of the direct debt claim before the bondholders saw any residual value – this is the practical or structural subordination issue. With this in mind, high yield bond investors have historically taken comfort with unlimited investment capacity in non-guarantor restricted subsidiaries in reliance on non-guarantor debt caps that limit the amount of debt that can be incurred by non-guarantor restricted subsidiaries.

As noted above, there has been significant convergence of term loan B covenant packages with traditional high yield covenant packages and the prevalence in the loan market of flexibility to make unlimited investment capacity in all restricted subsidiaries is no exception. Even with this construct, in a purely US domestic deal that does not involve (nor permit the creation or acquisition of foreign subsidiaries), lenders' exposure to value leakage would still be limited as most domestic subsidiaries would be required to guaranty and secure the loan obligations with a few exceptions, the most important one of which is an exception for immaterial subsidiaries. A large transfer of assets to any such immaterial subsidiary, however, would push it over the materiality threshold, requiring the borrower to designate that subsidiary or another immaterial subsidiary as a guarantor in order to once again satisfy the threshold.

In a US credit group that either has non-US subsidiaries or is permitted to include such subsidiaries in the credit group there are several other guarantee and collateral exceptions that come into play, which exceptions may exclude such non-US subsidiaries from the obligation to guarantee the loans (i.e., local law restrictions, adverse tax consequences, cost-benefit analysis), not to mention the broad exclusion for foreign subsidiaries noted earlier in this article that have persisted despite the changes to the US Tax Code. Despite not being guarantors, such foreign subsidiaries might still constitute restricted subsidiaries to which unlimited value could be transferred via the high yield-style investment covenant carveouts leaving lenders with a higher risk of value leaking outside of their collateral support group.

The same value leakage concern has become an issue in an increasing number of large covenant-lite European term loan B deals which – again modelled after the high yield bond market – permit free investments into all restricted subsidiaries (regardless of whether or not they are guarantors). Many of these deals may still include the guarantor coverage test discussed above, but that too has been diluted by the applicability of agreed guarantee and security principles that limit the requirements to provide guarantees and security (as well as the guarantor coverage test) to only some of the jurisdictions in which the credit group operates. The result is that, unless specifically negotiated otherwise, unlimited investments can be made into restricted subsidiaries organised in jurisdictions that are not "covered jurisdictions" and which, therefore, do not provide guarantees and collateral, without throwing off the percentage of EBITDA/assets necessary to satisfy the guarantor coverage test.

But, similar to the high yield market, while unlimited investment capacity in all restricted subsidiaries is now fairly common in both the US and European markets for large syndicated term loan B facilities, lenders have, for the most part, insisted that non-guarantor subsidiaries remain subject to a cap on debt incurrence (at least under the unlimited ratio-based incurrence carveouts). As noted above, by ensuring that unlimited debt cannot be incurred by non-guarantor subsidiaries that may become recipients of valuable assets and operations via intercompany investments, lenders can limit the degree to which structural subordination issues can impact the residual value that accrues to them from those subsidiaries.

This important interplay of the debt and investments covenants underscores that the potential for value leakage may not always be obvious and often requires a deep understanding of how covenant terms work together. Some high-profile deals in the US market over the past year have highlighted additional value leakage concerns. The now infamous J. Crew trapdoor provision that is included in a lot of existing precedents in the US market could lead to additional leakage via a seemingly innocuous provision allowing for non-guarantor restricted subsidiaries to make unlimited investments in unrestricted subsidiaries with proceeds of an initial permitted investment from the borrower or guarantor into the non-guarantor restricted subsidiary. Investors in both the US and European markets continue to be focused on this provision in recent transactions and have been resisting the inclusion of the trapdoor in new issue US and European term loan B facilities (including cross-border loans) and have introduced ways to limit its impact when included.

Lenders also watched closely as Petsmart took advantage of a provision that excludes any non-wholly owned subsidiary from the guarantee requirement. By distributing a portion of a valuable subsidiary's equity using dividend capacity, Petsmart was able to render the subsidiary into a non-wholly owned subsidiary and take advantage of favourable contractual language requiring the release of guarantors that become "excluded subsidiaries" following the closing date of the facility.

Neiman Marcus was also in the news this year in the US market when it designated a valuable subsidiary as an unrestricted subsidiary using its investment covenant capacity for unrestricted subsidiaries, and then distributed such unrestricted subsidiary (and all of the cash and assets held by it) upstream to its equity holders.

Some other differences to keep in mind between US and European markets

As one would expect, there is a host of different rules and regulations in each lending market. The following are just a few examples of some different standards, rules and regulations applicable between markets and, of course, market players should seek counsel in the relevant jurisdiction to fully understand what practical implications there are when seeking to place debt in a given market.

Assignments and transfers

Most English law-governed credit documentation that includes a term loan B tranche is being documented with European-style transferability provisions and restrictions, which are generally more restrictive on transferability of loans than the typical US market approach. So, the European approach of a permitted "white list" of lenders with the ability to remove a certain number of names on an annual basis after closing (as opposed to the US approach of a Disqualified Lender list, which typically cannot be updated after closing except for updates to include *bona fide* competitors), a blanket prohibition on transfers to loan-to-own or distressed investors, and expansion of transfer limitations to apply not only to assignments but also to participations and sub-participations and even certain derivative transactions has been maintained in most European term loan B deals (including some cross-border loans – notwithstanding the intent to syndicate the US dollar tranche in those deals to the US institutional market).

There has been a recent push to try to expand some of the more common European restrictions on transferability into traditional US term loan B deals (including cross-border loans), but these attempts have so far not gained widespread acceptance with US investors (where such tighter restrictions continue to be much more heavily resisted by investors). Based on US market reaction, we may well see deals in 2019 that include a bifurcated approach to transferability for different loan tranches, depending on the target market in which the tranche will be syndicated. It is therefore critical that underwriters, investors and other market participants understand the impact that these provisions may have on the overall liquidity of a particular tranche and the ability to freely enter into participations and similar transactions, in light of the intended syndication strategy for that tranche.

Regulatory clearance

While there are no specific regulatory constraints on the marketing or issuing of European borrower private debt into the US, where certain other products are being offered alongside bank loans, e.g. a concurrent US debt securities or notes offering, care must be given to respect the US "anti-tying" bank regulations and securities laws.

Shifting sanctions

Historically, governments between the United States and Western Europe have been, in a broad sense, aligned with respect to the states that were subject to the sanctions rules imposed by The Office of Foreign Assets Control of the US Department of the Treasury and the EU's Common Foreign and Security Policy, respectively. And, while there are numerous differences between the LMA approach and the standard US approach to sanctions representations and covenants, the countries covered by the sanctions rules themselves were sufficiently aligned to the degree that borrowers entering both markets were aware of the jurisdictions in which operations needed to be avoided so as not to cause issues for their prospective lenders. However, the widely reported recent fissure between US and European governments regarding Iranian sanctions indicates that this may not always be the case, going forward. So, market participants must not forget that while covenant terms continue to converge across the US and European syndicated loan markets, regulatory constraints can sometimes limit the degree to which certain categories of covenants and other terms can be assumed to operate similarly in both markets.

US co-borrower for US institutional market

Many institutional investors in the US leveraged loan market (CLOs in particular) continue to have investment criteria that govern the type of loans in which they may participate. These criteria usually include specifying the jurisdiction of the borrower of the relevant loans, with larger availability or "baskets" for loans to US borrowers, and smaller "baskets" for loans to non-US borrowers. As a result, some US cross-border loan deals have included US co-borrowers (even if they are only shell entities and borrowers in name only) in an effort to ensure that a maximum number of US term loan B institutional investors can participate in any US-dollar term loan financings. There is generally not a similar requirement in European market deals.

Differing market practices

The end of LIBOR

As banks, financial institutions and other market players around the world are well aware, the UK Financial Conduct Authority will no longer require London banks to report the London interbank offered rate (LIBOR) – the standard benchmark for floating interest rates in debt instruments – after the end of 2021 and, barring a stopgap measure, LIBOR is expected to no longer be available at that time. Financial markets around the world have used LIBOR for over three decades so the process and task of identifying an alternative is a daunting one that affects not only loans and other cash products but derivative instruments, as well.

Financial regulators, lending trade associations and financial institutions around the word are engaging in ongoing discussions about how best to deal with the phasing out of LIBOR and though there is still not firm unanimous consensus as to what the solution is, both US and European credit facilities in the term loan B markets executed during the previous two years have started including fallback provisions that aim to deal with a permanent LIBOR cessation. While in Europe, the LMA endorsed standard[vi] dominates the market, these provisions vary significantly in US transactions.

In the US, provisions to facilitate a switch to replacement benchmark started to appear in the latter half of 2017, but there are significant variations in these provisions with respect to: (i) what types of events trigger the switch to a replacement benchmark; (ii) mechanisms and procedures for implementing and documenting replacement benchmarks; and (iii) consent rights (while the vast majority of agreements include a negative consent approach (i.e., agent and borrower select the replacement rate and majority lenders have an opportunity to reject) there are some agreements that employ affirmative consent rights for either a majority or supermajority of lenders). Notably, some of the early forms of these provisions may not address the need to include certain pricing spread adjustments and therefore might still require an all lender consent.

An important nuance for market participants to keep in mind with respect to USD LIBOR and the US syndicated loan market is the existence of the "base rate" option. Deals with a USD LIBOR component in the US market have for decades included a "base rate" benchmark (usually based on the greater of the federal funds effective rate plus 50 basis points and the administrative agent's "prime rate" – with both of these rates presumed to be greater than LIBOR). The related provisions permit borrowers to elect for loans to be priced based on the base rate plus a margin instead of LIBOR plus a margin. Further, most US credit agreements have historically included provisions that would mandate the use of the base rate option as a fallback if LIBOR is unable to be determined. While that fallback provision is generally assumed to be applicable only upon temporary LIBOR disruption as opposed to permanent cessation, the very existence of an alternate reference rate does provide greater certainty in the US market as to the presence of some alternative should a permanent USD LIBOR replacement not emerge prior to the end of 2021. As the base rate fallback is unique to the USD LIBOR market, borrowers should take note that in the unlikely event that a true successor to LIBOR is not identified on time, their USD LIBOR debt may fall back to a more costly interest rate.

Certain funds vs. SunGard conditionality

Borrowers and sponsors in leveraged finance deals in the European market and the US market both strive to limit conditionality in a committed financing, particularly when the loan is funding an acquisition. Sellers in a given M&A transaction demand the assurance that the debt-financing component of their purchase price will be there at closing. But, there is also the recognition that certain conditions to the financing must be included. The result is an ever-diminishing limited universe of manageable conditions that can be satisfied with relative certainty and within the necessary M&A timeline.

Conditionality standards imposed by European vendors have historically been tighter (i.e., less stringent in nature and fewer conditions to be satisfied) than those in the US market, and European sellers are accustomed to this tighter standard. One of the key differences is that in most European deals, the parties will negotiate a version of all of the financing documents (including most deliverables such as opinions and certificates) that are to be used in the event that long form credit documentation is not be available when closing time arrives. Though the parties do not intend to enter into this basic version of the financing documentation, it provides a fallback that they can rely on if they are unable to reach an agreement on full long form credit documentation prior to the closing and funding of the acquisition.

European borrowers accessing US markets should be aware that US banks are accustomed to a more onerous (from a borrower's perspective) conditions package. Though US banks will limit conditionality to a manageable universe of items (known as SunGard conditionality), they do not negotiate any credit documentation prior to providing the commitment and the set of conditions, while limited, is more robust than a typical European certain funds package. This has changed somewhat in recent years in instances where US lenders have been lending to fund an acquisition with vendors based in Europe, but even in those instances, it is not a universally acceptable practice. So, prior to engaging with US banks for acquisition financing, borrowers seeking financing to support an auction bid for a Europe-based acquisition target should weigh the pros and cons of each market and recognise that the conditionality lenders may be willing to offer might depend on the market in which the loans will ultimately be syndicated.

Due diligence

Historically, in European transactions lenders were generally entitled to rely on diligence reports prepared by a borrower's advisors. That is not the case in the US market and, as a result, the lead banks in a US financing and their counsel undertake their own due diligence investigation of the borrower group, the target (in the acquisition context) and the subject transactions (although they are usually allowed to review the buy side reports on a non-reliance basis). While in reliance has also been limited or completely prohibited in a number of recent deals in the European market, underwriters and borrowers should consider this element of a syndication early on in the process so as to avoid unforeseen complications based on market expectations.

Public vs. private information

Due to US securities regulations, US institutional investors (including those that regularly participate in the term loan B market) take great care to distinguish between material non-public information relating to a corporate group and their securities and, alternatively, "public" information. To accommodate this sensitivity, for purposes of marketing these deals in the US term loan B market, borrowers are often required to take steps to ensure the "public" *vs*. "private" information distinction is respected, including by producing separate sets of marketing materials. As this is a lead-time item and one that would not be intuitive to European issuers, planning at the outset of a transaction with a cross-border loan being placed in the US markets should account for the time and resources required to satisfy this requirement.

Financial statements

In a similar vein, US term loan B investors will generally expect to receive and review historical financial statements of the borrower group that are prepared in accordance with US GAAP or IFRS. For a European borrower that has historically employed the "local" GAAP of its home jurisdiction, it would be advisable from a term loan B marketing and liquidity standpoint to instead (or additionally) prepare its consolidated financial statements on the basis of the internationally recognised standards.

Opinion practice

Another example where markets have developed different approaches is with respect to legal opinion practice. It has been the norm in deals across Europe that lender's counsel issues the legal opinions with respect to enforceability of the credit documentation while the US norm is for borrower's counsel to issue all opinions including those that go to enforceability. There is also a distinction between what opinions law firms are typically willing to give between the two markets. For example, firms delivering opinions on European deals regularly opine as to choice of law whereas many US-based firms are more hesitant to do so. These distinctions rarely prove insurmountable in practice, but borrowers and lenders should be conscious of such differences in the interest of smooth deal execution.

Conclusion

As terms (and some practices) have converged between the US and European debt markets, borrowers are able to venture into either market with greater ease. Barring any unforeseen liquidity crunches, this convergence will likely continue. Borrowers and lenders should be aware of those differences that remain between the two markets but should also take advantage of the wider pool of capital. This will be especially true for sponsors entering into complex cross-border acquisitions where purchase prices may need to be funded in multiple currencies and in multiple jurisdictions – all of which can now be done under a single credit agreement governed by either NY or English law. In today's climate, different currency tranches could more readily be syndicated in their respective markets where financial investors are increasingly becoming comfortable with accepting terms that were historically only found in one or the other market. All borrowers with multi-jurisdictional operations, including those that are looking for refinancing opportunities, should be encouraged to explore opportunities for a cross-border loan financing, particularly if such financing can provide better pricing along with terms that are generally familiar to the borrower and the prospective loan investors.

Endnotes

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Chapter 15

Debt Retirement in Leveraged Financings


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A company borrows money. It would like to avoid any requirements to mandatorily prepay the debt before its maturity, such as on the occurrence of some event or contingency, in order to retain the economic benefits of that arrangement and avoid the need to raise or deploy cash to meet a required prepayment. At the same time, it would like to maximise its flexibility to voluntarily prepay the debt before its maturity, such as to refinance at a cheaper cost of capital, or to obtain less restrictive terms in order to facilitate a transaction or other operational needs.

An investor lends money. It would like to ensure that it can have the debt prepaid if an event or contingency affecting the credit occurs, such as an asset disposition or change of control. At the same time, it would like to protect itself against an unexpected prepayment of the debt at the company's election, forcing the investor to redeploy its capital and lose the benefit of its investment.

The interplay between these competing goals of a borrower and its creditors shapes the prepayment requirements and protections in financing agreements. These provisions further evolve over time with changes and developments in financing markets and products. This article will discuss prepayment requirements and protections in leveraged financing agreements, as well as prepayment and refinancing techniques employed by borrowers, focusing principally on custom and practice in the United States leveraged financing markets for large cap transactions.

Mandatory Prepayment Requirements[1]

Syndicated Term Loans. Traditionally, syndicated term loans in leveraged financings have had a number of mandatory prepayment requirements. Like other features, these requirements have evolved over the years as the syndicated term loan product and debt capital structures have changed and become more complex. The syndicated term loan market has changed fairly dramatically over the last three decades, moving from a market characterised by relatively modest sized loans made and held by commercial banks to one dominated by sizable loans arranged and sold to institutional investors. Given these changes, this article will focus principally on current market practice and recent developments with respect to common mandatory prepayment requirements for syndicated term loans.

Syndicated term loans typically require prepayment with the net proceeds of specified asset dispositions and recovery events with respect to property, commonly after a period during which the borrower is entitled to apply the proceeds to reinvest in its business or repair or replace property, and subject to monetary thresholds. In many recent transactions, the portion of the net proceeds that is required to be applied varies based on a leverage-based financial ratio, commonly beginning with 100%, and declining with step-downs based on meeting agreed ratio levels. Often in transactions which provide for such step-downs, the proceeds which the borrower may retain are available for restricted payments – this feature faces investor pushback in choppy markets or for tighter credits. Over the years, the feature has evolved to provide the borrower with greater flexibility to reinvest the net proceeds of asset dispositions in its business rather than using such net proceeds to prepay indebtedness. Typically, any such reinvestment must occur within 12 to 18 months after receipt of the net cash proceeds from the asset disposition. In addition, the feature has evolved to exclude various types of transactions from the prepayment requirement. Its basic purpose, however, remains the same: to protect the investor against substantial changes in the assets of the business that may negatively affect the credit, including collateral coverage.

Term loans also commonly require a percentage of "excess cash flow" to be applied to prepay the loans, with the percentage varying with a leverage-based financial ratio, commonly beginning with 50%, and declining to zero when an agreed ratio is met. Excess cash flow is calculated for each fiscal year and any prepayment is made annually. In more recent transactions, the prepayment requirement is subject to meeting a monetary threshold before any prepayment must be made. The excess cash flow calculation can start either with net income and add back non-cash deductions, or with EBITDA and subtract non-cash additions. The former approach has become more common in recent years. The calculations have become increasingly complex, particularly for larger and more complex businesses. In many recent transactions, deductions for investments and capital expenditures have been shifted from the definition of excess cash flow and instead applied to reduce the amount of prepayment due after excess cash flow has been calculated and the applicable percentage applied, resulting in full rather than partial credit for those payments. In addition, excess cash flow calculations now commonly take into account and deduct not only prior prepayments during the measurement period on the term loans themselves, but also on other debt secured with equal priority by the same collateral package, further adding to the complexity of the calculation. Recently, some more borrower-favourable transactions have included deductions for amortisation payments made on the term loans themselves, but also on other debt secured with equal priority by the same collateral package. The excess cash flow prepayment requirement allows an investor to share in the cash flow generated by the business's performance in a good year, as a hedge against performance in a bad year. For a borrower, on the other hand, the excess cash flow prepayment requirement presents potential risk: if the calculation formula has missed something significant, the borrower could be facing a prepayment requirement that it is not anticipating or prepared for. In addition, paying out cash after a good year may result in a leaner cushion if performance declines in a future period. A borrower thus has a substantial incentive to try to shape the excess cash flow formula in a way that minimises the amount calculated. Term loans traditionally have offered a countervailing incentive, by allowing the borrower to increase "basket" capacity to make dividends and investments and take other actions by the amount of excess cash flow retained by the borrower. More recently, term loans have evolved to increase basket capacity by other means – for example, a percentage of consolidated assets, or 12-month EBITDA – and in some instances have moved entirely away from the retained excess cash flow construct.

A third common prepayment requirement relates to the incurrence of debt: A borrower must prepay its term loans if it incurs debt other than debt that is permitted by the term loan credit agreement. The evolution of debt incurrence features in credit agreements in recent years, providing enhanced flexibility to incur debt, including adding additional secured debt to the same collateral package, has made this prepayment requirement in many cases largely meaningless, and as a practical matter merely a way of refinancing the term loans without resorting to the voluntary prepayment features.

Syndicated term loans commonly give the investor the option to decline mandatory prepayments from the proceeds of asset dispositions and recovery events, or from excess cash flow, while some syndicated term loans provide the borrower with the option of whether to offer the investor an option to decline. If the investor is happy with the investment and comfortable with the continuing credit, it may want to keep the investment and decline the prepayment. If, on the other hand, the term loan is trading at a significant discount, the prospect of a prepayment at full principal amount can create an incentive for investors to closely scrutinise a borrower's calculation of amounts subject to mandatory prepayment and enhance the need for the borrower to exercise care in that calculation.

Although not structured as a prepayment provision, syndicated term loans effectively require prepayment on the occurrence of a change of control, which typically constitutes an event of default entitling the lenders to require prepayment. How a change of control is determined, and what constitutes a change of control, has evolved over the years. Some term loans deem the change of control default to be waived or otherwise not to occur if the borrower has offered to prepay the term loans and has done so for all term loans tendered for prepayment, a construct that in effect is similar to the option to decline prepayment from asset proceeds or excess cash flow.

High-Yield Bonds. Since the early days of the high-yield bond market, high-yield bonds have required the borrower to offer to prepay bonds from the proceeds of specified asset dispositions, typically after complying with any requirement to prepay any more senior debt, and after a period of time to reinvest the proceeds in the business. For high-yield bonds, the prepayment requirement is coupled with the covenant restriction on asset dispositions. This provision requires that, if a specified asset disposition occurs, the borrower must receive fair value, the consideration must largely consist (commonly, 75%) of cash or the equivalent, or other specified types of consideration, and the net proceeds must be applied to reinvest in the business or to prepay more senior debt, and after a period of time to make an offer to prepay the bonds. As a sign of convergence between the high-yield and leveraged loan markets, many credit agreements now also permit asset dispositions for which the borrower has received fair value and the consideration is in the form of cash or the equivalent, or other specified types of consideration. As with the similar requirement for syndicated term loans, the bond prepayment requirement has evolved over the years to take into account increased business complexities and to provide the borrower with greater flexibility to make changes in its business without being required to prepay debt. The range of transactions excluded from the asset disposition restriction, the items that count toward the consideration percentage requirement or are deducted in calculating net proceeds, and the time period in which the borrower can otherwise apply the net proceeds, have all expanded substantially over the years. The application of proceeds "waterfall" has become more complex to take into account the potential for multiple bond and other financings with similar application and prepayment requirements. In some instances, the cash consideration threshold requirement has moved away from a test applicable solely to the consideration received for an individual asset disposition or a series of related asset dispositions to a test for all consideration received in connection with all asset dispositions since the issue date, allowing potentially greater flexibility for individual transactions. In addition, a feature has begun to appear that is reminiscent of the early days of high-yield bonds, providing that under certain circumstances, the application of proceeds requirement does not apply to a specified portion of the net proceeds of an asset disposition. In the early days, the provision might only cover 80% of the net proceeds absent default. Under the modern construct, the percentage steps down from 100% to a lesser percentage or to zero if a financial ratio is met. This provision thus can effectively suspend the operation of the asset disposition covenant restriction and prepayment requirement so long as the borrower meets a specified ratio. In addition, the asset disposition provision, including the proceeds application and prepayment requirements, is often one of a number of high-yield bond covenant restrictions that are suspended upon achievement of investment grade ratings.

A second prepayment provision that has long been a feature of high-yield bonds requires the borrower to offer to prepay the bonds, typically with a 1% premium, if a change of control occurs. As with syndicated term loans, how a change of control is determined, what constitutes a change of control, and the range of permitted transactions and equity holders, have evolved considerably over the years, in part to account for the complexity of the "beneficial ownership" concepts under US federal securities laws that underlie the typical change of control test in high-yield bonds; increasingly, these change of control provisions lock in these references to the US federal securities laws as in effect on the issuance date in order to avoid unforeseen consequences that might result from future changes to these securities laws.[2] The so-called "portability" construct that has become common in European high-yield bonds, permitting an acquirer to assume the bonds if specified financial or other requirements are met, has not gained significant traction in the US market; however, a number of recent transactions have included "portability" construct and such technology has been successfully utilised in connection with recent acquisitions of companies by financial sponsors. However, some US high-yield bonds, particularly those that are higher rated, require that a ratings downgrade occur in addition to a change of control, before the prepayment offer is required to be made. While offering an additional measure of protection to the borrower, the additional ratings downgrade requirement does not necessarily make things easier for an acquirer: the downgrade often can occur during a period of time after the change of control and still trigger the prepayment offer requirement, which may complicate an acquirer's financing plans.[3]

Other Leveraged Financing Products. Other leveraged financing products include such financing types as second lien term loans, as well as so-called "mezzanine" debt, which may be subordinated contractually in right of payment to other senior debt, or subordinated structurally by having been borrowed by a parent of the borrower of other debt. These products generally will provide for prepayment requirements similar to those for syndicated term loans and high-yield bonds. Second lien term loan provisions commonly will parallel those applicable to the syndicated term loans having first lien priority. Mezzanine debt may follow either a term loan or bond construct or a mix of both.

Protections Against Voluntary Prepayment by Borrower

Syndicated Term Loans. Traditionally, syndicated term loans have generally been prepayable without premium, on relatively short notice. This relative lack of prepayment protection is coupled with the variable interest rate nature of this financing product, which provides the investor with a rate of return that continually adjusts to the current interest rate environment.

In recent years, the syndicated term loan market has evolved, with institutional investors dominating the buy side, and opportunistic repricings and refinancings becoming more common. Prepayment protections too have evolved, with a relatively modest premium (typically 1%) being payable in connection with refinancings and amendments principally aimed at achieving a lower interest rate and thus a cheaper cost of capital. This so-called "soft call" protection will commonly fall away after a period of six months to a year, giving the investor some period in which it has some assurance that it will realise the benefit of its investment, while at the same time preserving for the borrower the flexibility to refinance or reprice on better terms after the soft call expires.

High-Yield Bonds. Traditionally, debt securities such as bonds have provided investors with a substantially greater degree of prepayment protection, corresponding to the generally fixed interest rate nature of this financing product. The fixed rate provides the investor with a predictable rate of return over a period of time, and the prepayment protection provides a degree of assurance that the investor will continue to receive that return over time, or an enhanced return in the form of a premium payable on prepayment of the investor's bond investment.

Investment grade bonds commonly have relatively long maturities, few covenant restrictions, and if they are prepayable at all, are prepayable only at a premium calculated at a so-called "makewhole" formula that typically results in a very expensive, if not prohibitive, refinancing cost. The effectively permanent nature of this capital is acceptable to the borrower because the covenant restrictions on the operation of its business are few and relatively benign.

In contrast, below investment grade, or high-yield, bonds typically have a maturity not exceeding 10 years – eight years is very common in the current market – and a significantly broader array of covenant restrictions aimed at protecting the investor against a wider scope of possible changes to the business and its creditworthiness that may be of greater concern given the lower credit quality of the borrower. The greater potential for these covenant restrictions to interfere with the evolution of the borrower's business and its owners' goals for their investment give the borrower a greater interest in being able to prepay its high-yield bonds at a reasonable cost: the more restrictive the contract, the more the borrower is incentivised to have the flexibility to terminate the contract and free itself from those restrictions.

High-yield bond prepayment protections have evolved over the years. In the early days of the high-yield bond market, bonds commonly were not prepayable at all for a period of time, and thereafter would become prepayable at a fixed premium that declined to zero over time. That prepayment feature has remained a common term, but has undergone some changes. For many years, the so-called "call schedule" would begin at the midpoint of the life of the bond – for an eight-year bond, after four years; for a 10-year bond, after five years – and the initial "call" premium would be one-half the interest rate, scaling down ratably to zero for repayments made within two years of maturity. More recently, as the market has moved to an eight-year senior unsecured bond paradigm, the call schedule has moved to begin three years out instead of four, with an initial "call" premium that at first was set at three-quarters of the interest rate, but now may be seen beginning at one-half the interest rate as in the earlier call schedule construct.

New prepayment features have appeared over the years, principally aimed at mitigating the impact of the absolute prepayment, or "noncall", protection during the early life of the bond. First, high-yield bonds came to incorporate a provision permitting the borrower to prepay up to a specified percentage of the outstanding amount of bonds using proceeds of a new equity issuance received by the borrower at a premium lower than a makewhole-based premium, so long as a minimum amount of bonds remains outstanding to assure sufficient liquidity for secondary trading. Initially the feature was focused on public equity offerings, on the theory that going public and paying down debt would be a credit-enhancing event and accordingly one that merited allowing the borrower to make a partial prepayment at a lower premium than a makewhole. The feature now commonly applies to any equity issuance by or contribution to the borrower. Typically the so-called "equity claw" can only be exercised during the first three years of the life of the bond, at a premium equal to the interest rate – more expensive than the premium payable when the call schedule becomes available, but less expensive for most if not all of the first three years than the makewhole feature now common in high-yield bonds, as discussed below.[4] For many years, the equity claw typically was exercisable for up to 35% of the outstanding amount of bonds, so long as 65% remained outstanding thereafter. More recently, the feature increasingly has permitted up to 40% to be prepaid, so long as 50% or sometimes 60% remains outstanding.

A second prepayment feature that has become common permits prepayment during the "noncall period" at a premium calculated at a makewhole formula, similar to the feature found in investment grade bonds. Early versions of the provision were commonly limited to voluntary prepayment upon a change of control, but it evolved to permit prepayment at the makewhole premium without restriction. The refinancing cost using the makewhole feature, while still substantial, is less prohibitive than for an investment grade bond, initially because of the shorter maturity of a high-yield bond, and later because the makewhole formula became tied to the prepayment amount payable at the first date on the call schedule rather than at maturity; this significantly reduces the makewhole premium because the amount payable at that first call date is significantly less than what would be payable at that date using a makewhole formula.

A third prepayment feature that has gained some currency is typically seen only in a secured bond context. It permits the borrower to prepay up to 10% of the outstanding amount of bonds in any 12-month period at a 3% premium, and again typically can only be exercised during the first three years of the life of the bond. The feature is based on the theory that secured bonds are incurred as a substitute for secured term loans, which as previously noted are generally prepayable without any premium, and accordingly the borrower should have some enhanced flexibility to prepay this alternative type of secured debt.

A final prepayment feature that has appeared more recently permits the borrower to prepay any bonds remaining outstanding after a tender offer has been made for the bonds in which at least 90% of the bonds have been tendered for payment, at the same price as paid in the tender offer. Thus, if, for example, the borrower has made an offer for its bonds following a change of control as required by their terms, typically at a 1% premium, and at least 90% have been tendered, the borrower can prepay the remaining bonds at the same premium. In certain situations, purchasers seeking to acquire a company with outstanding bonds in the makewhole have been able to structure the transaction in a manner that permits utilisation of the "equity claw" described above to redeem a portion of the bonds and redemption of the remaining bonds at the makewhole. Structuring a transaction in such a way allows the purchaser to achieve a lower blended cost associated with the redemption of the bonds.

High-Yield Bonds: Impact of a Bankruptcy. Negotiating for redemption flexibility in bonds could have unforeseen consequences when tested in court in a bankruptcy or insolvency proceeding. The United States Court of Appeals for the Third Circuit has held in the Energy Future Holdings case[5] that the repayment of notes following their automatic acceleration resulting from a voluntary bankruptcy filing requires payment of the redemption premium that would otherwise be due on a voluntary redemption. The United States Court of Appeals for the Second Circuit, to the contrary, has held in a similar situation in the Momentive case[6] that the plain meaning of "redeem" is to repay "at or before maturity", that acceleration brought about by a bankruptcy filing changes the maturity of the accelerated notes to the date of the bankruptcy petition, and therefore that any repayment made in connection with a bankruptcy filing is made post-maturity and is not subject to payment of a redemption premium. One consequence of these conflicting court decisions is that filing for bankruptcy in the Second Circuit may lead to a preferred result for an issuer compared to filing in the Third Circuit.

Other Leveraged Financing Products. Prepayment protections for alternative lending products, such as second lien term loans and mezzanine debt, can vary to a greater extent than for syndicated term loans or high-yield bonds, but generally tend to be fairly modest in comparison to high-yield bond protections. These products often can be prepaid immediately or after a short period of time at modest premiums that decline fairly quickly to zero. The relatively benign prepayment cost involved makes these products attractive to borrowers.

Prepayment and Refinancing Techniques

The preceding section, in describing prepayment protections, also summarised a number of features permitting a borrower to voluntarily prepay its debt. This section will discuss the ways in which these provisions can be used by the borrower, as well as other features of the financing agreement and approaches external to the agreement that can be deployed to prepay, reprice, extend or otherwise retire debt.

Syndicated Term Loans. Syndicated term loans typically can be voluntarily prepaid on short notice, generally three business days in the case of loans bearing interest at a rate based on LIBOR. Traditionally, that notice was irrevocable, but when lending syndicates were relatively small and made up of commercial banks, it was generally feasible and accepted practice to obtain a so-called "payoff letter" that waived the notice requirement. In addition, in the case of a complete refinancing, the requirement to mandatorily prepay the term loans with the proceeds of a debt financing not otherwise permitted could be used to effectively sidestep the notice requirement. As term loans and lending syndicates became larger and the market moved to an institutional investor base, it became increasingly important to the borrower that it have the ability to revoke its prepayment notice if some contingency did not occur, such as the closing of a refinancing or of an acquisition of or by the borrower. It is now common for term loans to allow the borrower to give prepayment notice on a conditional basis, permitting the notice to be withdrawn or extended if a given condition does not occur.

Modern syndicated term loans commonly provide a number of other options for prepaying, repricing, extending or otherwise retiring that debt, which have generally appeared over the last decade or so. One of the earliest features to appear is a set of provisions providing a fairly elaborate mechanic for the borrower to make an offer to prepay some or all of its term loans, open to all lenders, at a stated price or range of prices, similar to a tender offer for bonds or other securities. While this feature remains common in syndicated term loans, it has fallen into disuse as other debt retirement options have developed. In particular, syndicated term loans now often allow the borrower and its affiliates to acquire loans in open market purchases from individual lenders, without the need to make a prepayment offer to all lenders. Loans acquired by the borrower are generally required to be retired, while loans acquired by an affiliate such as a private equity sponsor are generally subject to certain restrictions, such as a limit on the amount of loans the affiliate can hold and on what voting rights the affiliate can exercise; though in some recent deals, the traditional caps on the amount of debt held by affiliates has been increased. The open market purchase option is generally faster, cheaper and more efficient than resorting to the prepayment offer mechanics.

Syndicated term loans now often allow for partial or full prepayment from a permitted refinancing facility created under the same term loan agreement. This feature will often impose a number of requirements that the permitted refinancing will have to meet. Perhaps in part as a result, the feature has not proven as popular in the context of a complete refinancing as another option, the uncommitted "incremental facility" feature. This provision allows the borrower to add new term loans under the existing term loan agreement subject to a monetary limit or compliance with a leverage-based financial ratio, the calculation of which will give *pro forma* effect not only to the incurrence of the new incremental term loans but also to the prepayment of the existing term loans with the proceeds. The new term loans often will be offered first to existing term lenders, and then to new investors. Some existing lenders for internal reasons may want to exchange their existing term loan for a new term loan, rather than fund cash and then be repaid, in a so-called "cashless rollover". The cashless rollover raised complications under some older term loans, but more recent term loans often expressly allow for it. The incremental refinancing may be used simply to "reprice" the borrower's term loans – that is, to obtain a lower interest rate but make little or no other changes – or it may be used to extend the maturity of the borrower's term loans and make other changes to the agreement.[7]

A simple term loan repricing can also be done by an amendment to the term loan agreement that just changes the interest rate. While such an amendment requires all lenders to consent, term loans today typically permit the borrower to require non-consenting lenders to assign their loans to another party once a majority of lenders have consented to the amendment – the so-called "yank a bank" mechanism – which will allow the borrower to obtain the necessary consent. Similarly, syndicated term loans commonly allow for an amendment to extend the maturity of the existing term loans, instead of incurring new debt with a longer maturity to refinance the old debt. The extension amendment can be effective for only a portion of the outstanding term loans. It can also make other changes to the agreement that would otherwise be permissible with necessary lender consent, and the "yank a bank" mechanism can be deployed once a majority of lenders have consented.

The amendment approach has tended to be disfavoured by financial institutions engaged by borrowers to assist in effecting the repricing or extension, because it can make arranging and allocating the repriced or extended loans to new investors more complicated in practice than an incremental refinancing to effect the same repricing or extension. However, more recently, principally to avoid the need for a new CUSIP number and the resulting potential for increased rating agency fees, arrangers and borrowers have reverted to the "yank a bank" approach, or have adopted an approach in which a new term loan is funded to pay off non-consenting lenders, with that new loan being deemed part of the repriced or extended loan and accordingly fungible with it as part of a single term loan. In some cases, the rating agencies have waived the higher fees, facilitating the use of the incremental loan approach.

High-Yield Bonds. As discussed in the previous section, high-yield bonds give the borrower a number of options to prepay, or "redeem", the bonds at varying costs depending on when and how the prepayment is made. Traditionally, notice of prepayment had to be given at least 30 days and not more than 60 days in advance, and once given was irrevocable. The inability to revoke the notice once given meant that many transactions, such as those financing an acquisition of the borrower and the repayment of the bonds, had to be structured in other ways, often to provide instead for a tender offer for the bonds, or for a "redemption and discharge", as discussed below. In the late 1990s, our firm introduced a "conditional redemption" feature to the high-yield bond market, giving the borrower the ability to give the notice of prepayment of the bonds but subject to the satisfaction of one or more conditions. The prepayment still had to be made not less than 30 days and not more than 60 days after notice, but the borrower had the flexibility to delay the prepayment within that 30-day period to permit the specified conditions to be met. This innovation allowed the borrower to effect the prepayment with a relatively simple notice, without the cost and complexity of a tender offer. This feature has become increasingly common in the high-yield bond market, as borrowers have come to appreciate its efficiency and cost-effectiveness. It has further evolved in recent years, allowing notice to be given as little as 10 or 15 days in advance, and for the prepayment date to be extended beyond the traditional 60-day limit as needed to satisfy the specified conditions, in a manner similar to how a tender offer can be conducted. The ability to extend beyond 60 days makes it unnecessary to revoke the notice and issue a new notice, starting the clock over.

The tender offer is the traditional alternative to the voluntary "redemption", or prepayment, of high-yield bonds. Because bonds are securities, the tender offer is subject to rules governing debt tender offers under the US federal securities laws. These rules among other things require the offer to be held open for 30 days, but as a matter of interpretation allow the party making the offer to begin to accept tendered bonds for payment after 15 days, facilitating completion of the prepayment of the bonds more quickly than the 30-day minimum for a traditional voluntary prepayment discussed above. The tender offer also can be extended as necessary for any specified condition to be met, and is not subject to a set maximum limit on extensions similar to the 60-day maximum for a traditional voluntary prepayment discussed above. Holders of the bonds are not obligated to participate in the tender offer. However, the tender offer is typically coupled with a solicitation of consents to eliminate, or "strip", essentially all the restrictive covenants with majority consent, as an inducement to participate in the tender offer. Once a majority have consented, the remaining investors must either tender or be left without covenant protections, and typically a very high percentage of the bonds wind up tendered. Pricing can be set, and later adjusted if need be, to achieve sufficient market acceptance. Equal treatment may be required contractually for consent payments, but tender offers can provide for differential consideration to different series of bonds based on differing bond values. The principal drawbacks to a tender offer are that the documentation is more complex and the costs greater for a tender offer than for a voluntary prepayment, making the modern "conditional redemption" feature discussed above an attractive alternative in many cases.

High-yield bonds commonly provide two other features that can be deployed in retiring that debt. First, high-yield bonds typically provide for the "satisfaction and discharge" of the bond agreement, or "indenture", on payment in full of the bonds. Many high-yield bonds also allow satisfaction and discharge if the bonds will mature or can be "redeemed", or prepaid, within the next year: the company simply deposits funds with the bond trustee to cover all future payments due through maturity or prepayment, together with a notice of prepayment if the bonds will be prepaid prior to maturity. The discharge is then effective, and all covenant restrictions under the bonds terminate. A satisfaction and discharge can be coupled with a voluntary prepayment, or "redemption". A "redemption and discharge" is fairly straightforward, and need not involve substantial out-of-pocket costs. But it may be more expensive than a simple redemption, because the company must deposit funds for a period of time prior to the redemption occurring, potentially increasing its interest expense or other cost of capital. In addition, the contractual conditions required to be met to effect the discharge need to be carefully assessed for practical concerns; for example, a requirement that no default exist could present an obstacle to a transaction should a default come to light at the last minute. Bonds called at a makewhole premium, or bearing interest at a variable or "floating" rate, may raise calculation issues with respect to determining the amount to be deposited, if the bonds have not expressly addressed that calculation in advance.

Second, high-yield bonds typically also provide for "defeasance" of bonds, by depositing funds with the trustee to cover all future payments through maturity or redemption. Defeasance is not limited to the one-year look forward limitation applicable to the discharge option – bonds can be defeased at any time. "Legal" defeasance terminates all substantive obligations, but is typically not possible as a practical matter because a common condition to legal defeasance requires delivery of a tax opinion that cannot be given under current US federal tax law. "Covenant" defeasance only terminates specified covenants and related defaults. It may be unattractive economically, and again the contractual conditions to covenant defeasance, such as absence of default, may pose practical concerns. Bonds called at a makewhole premium, or bearing interest at a "floating" rate, again may raise calculation issues with respect to determining the amount to be deposited.[8]

Endnotes

1. Financing products use differing terminology for similar things. A company that incurs debt as a term loan is a "borrower", but is an "issuer" if it incurs debt as a bond. A company "prepays" a term loan, but "redeems", "repurchases" or "calls" a bond. Term loans are "borrowed" under a "credit agreement", while bonds are "issued" under an "indenture". For simplicity and clarity, this article will generally use the same terms regardless of which product is being discussed.
2. See, e.g., Laurent Alpert and Robert Guszecki, *Indentures and the Brokaw Act*, Harvard Law School Forum on Corporate Governance and Financial Regulation (May 2, 2016), https://corpgov.law.harvard.edu/2016/05/02/indentures-and-the-brokaw-act/0.
3. The requirement to make a change of control prepayment offer has made some inroads in the investment grade bond market, responding to investor pressure for an option to exit in the event of a leveraged acquisition or similar credit-changing event.
4. For an eight-year bond that becomes prepayable after three years at half the interest rate (known as "8 noncall 3"), a makewhole prepayment may be less expensive during the final six months of the three-year period than an equity claw prepayment.
5. *In re Energy Future Holdings Corp.*, 842 F.3d 247 (3d. Cir. 2016).
6. *In re MPM Silicones, LLC*, 874 F.3d 787 (2d Cir. 2017).
7. One constraint on the incurrence of incremental term loans is that, to the extent that existing term loans remain outstanding and the effective interest rate on the new loans exceeds that on the old loans by more than a stated differential (commonly 0.5%, or 50 basis points), a "most favored nations" or MFN

provision will typically require the old loans to be repriced to that differential. The MFN provision may be subject to a so-called "sunset", and expire after a period of time. It would not in any event apply in the case of an incremental financing in which the old loans are repaid in full.

8. Under case law, an issuer cannot impose "in substance" defeasance absent a provision permitting defeasance. See *Rievman v. Burlington Northern Railroad Company*, 618 F. Supp. 592 (S.D.N.Y. 1985).

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Analysis and Update on the Continuing Evolution of Terms in Private Credit Transactions

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For the past eight years, The Private Credit Group at Proskauer Rose LLP has tracked deal data for private credit transactions (our "data"). The data referred to in this article reflects trends and evolving terms in over 188 private credit transactions closed by The Private Credit Group at Proskauer Rose LLP in 2018 and may not be indicative of overall market trends. In prior years, our data reflected that, as the market became more competitive, the middle market experienced an influx of financing terms that were once only found in large cap financings. While middle market transactions had not fully incorporated the complete slate of large cap financing terms, the increasing competition for deal origination resulted in the selective inclusion of certain large cap financing terms, albeit with a middle market orientation. In 2018, large cap financing terms remained strongly planted in the middle market but were generally less prevalent as compared to what the data demonstrated in prior years. Although the middle market experienced a slowdown in the migration of such terms, middle market lenders have a limited ability to unwind provisions that have been adopted. As such, we expect the influx of large cap financing terms to continue. Given that large cap terms assume a profitable and durable business model, middle market lenders react to the introduction of large cap terms with additional conditionality and risk mitigants as deal sizes get smaller and the borrower's business model is less able to withstand adverse economic results. Middle market lenders' appetite for certain of these large cap financing terms differ not only based on institutional biases, but also based on the size of the borrower's consolidated EBITDA. As a result, the evolution of these large cap financing terms can be traced, in certain respects, to the size of the borrower's consolidated EBITDA. This results in a further division of the middle market into the "lower middle market", "traditional middle market" and the "upper middle market". This article will analyse the continuing evolution of certain key financing terms in the private credit middle market as well as discuss the related market drivers and trends influencing such terms. The analysis will provide a description of the terms, proprietary data pertaining to the usage of such terms within the traditional middle market across various industries, and future changes to such terms in light of the continuing evolution of the private credit identity and market variables.

Overview of Proskauer Rose LLP Private Credit Transactions in 2018

The top five industries represented in middle market transactions, as shown in our data, include (a) business services, (b) consumer, (c) healthcare, (d) manufacturing, and (e) software and technology. These primary industries comprise 74% of our deals in 2018. Notably, manufacturing deals have increased to represent 17% of all our deals in 2018 while health care deals showed the biggest decline from 27% in 2017 to 15% in 2018. First lien and second lien transactions increased for the year; whereas mezzanine loan transactions continue to decline in popularity falling to 5% of all deals in 2018 compared to 8% in 2017. Interest rate margins (the percentage points added to a benchmark rate for purposes of calculating a floating or variable rate) across all deal types in our data have trended lower since 2015. In 2015, only 16.7% of deals had margins less than 7.0%. The percentage of deals having margins less than 7.0% increased to 31.8% in 2016, 38.2% in 2017, and 51.4% in 2018. However, the impact to lenders of decreasing interest rate margins is partially offset by a steady increase in the LIBOR benchmark in recent times. With respect to commitment fees and OID, in 2018, 54% of commitment fees and OID were between 2.0%–2.49% of the principal amount of the loans and commitments at closing, which is generally consistent with the levels for 2017.

Closing leverage for middle market transactions in our data remains stable with only a slight increase from 5.00× in 2017 to 5.20× in 2018, with 78% of deals having a closing leverage between 4.00× and 6.99× (consistent with 80% of deals in 2017). In comparison to 2017, covenant lite deals in our data remained consistent in 2018 at 14% of our deals with EBITDA greater than $50MM; however, we have seen an increase in our data of transactions where the financial covenant cushions are equal to or greater than 40%. Although financial covenants generally include total leverage ratio tests, 33% of our deals also included a fixed charge coverage ratio test which is down 8% from 2017. Of the transactions with financial covenants, 67% of them had five or more covenant step-downs and of these transactions, 84% of them had EBITDA of less than $50MM. In transactions with EBITDA greater than $50MM, only 28% of them had a cap on general non-recurring expenses as an add-back to EBITDA; whereas in transactions with EBITDA that is less than $50MM, 70% of them had a cap on general non-recurring expenses. It is worth noting that the loosening of parameters relating to the calculation of consolidated EBITDA in the traditional and upper middle market, including the increased prevalence of addbacks for run-rate cost savings and synergies, and larger caps (or the absence of caps) on addbacks generally, may be directly affecting closing leverage multiples and resulting in more forgiving financial covenants. Additionally, in connection with the general trend towards borrowers' counsel controlling the drafting process at both the commitment stage and the definitive deal documentation stage, an increasing percentage of our traditional middle market deals in 2018 were initially drafted by borrowers' counsel. In certain circumstances, the borrower also selects the precedent credit agreement to be used in a particular transaction (which may not have been a transaction in which the lender participated, or which may reflect a more upper market orientation than the current deal). Due to time sensitivity in certain transactions during the commitment stage, the lenders may find themselves agreeing to precedent credit agreements which could result in the lender accommodating terms that are more typically found in larger transactions.

Debt Incurrence

The flexibility given to borrowers to incur additional debt either within or outside the applicable loan facility continues to be one of the most transformative structural changes to make its appearance in the middle market.

Incremental Facilities and Incremental Equivalent Facilities

Leading the way in providing greater flexibility to borrowers is the evolution of incremental and incremental equivalent loan facilities. An incremental facility (also commonly referred to as an "accordion") allows the borrower to incur additional term loans or revolving loan commitments under the existing credit agreement within certain limitations and subject to certain conditions, without the consent of the existing lenders. Incremental equivalent debt has the same features of an incremental facility except that the debt is incurred outside the existing credit documentation, either pursuant to a separate credit facility or through the issuance of notes outside of the credit agreement (either issued in a public offering, Rule 144A or other private placement).

The migration of these additional debt facilities into the middle market can be summarised as follows: (a) the upper middle market will generally accommodate both incremental facilities and incremental equivalent facilities; (b) the traditional middle market is increasingly accommodating both incremental facilities and incremental equivalent facilities (subject, however, to stricter conditions, as discussed below) but remains stratified with respect to incremental equivalent facilities in approach depending on the consolidated EBITDA of the borrower and the leverage of the borrower and its subsidiaries; and (c) lower middle market deals generally do not provide for incremental or incremental equivalent facilities. Our data shows that 71% of traditional middle market deals include incremental facilities with 39% including both incremental facilities and incremental equivalent facilities, compared to 86% and 53%, respectively, from 2017.

Incremental Amount

- In large cap transactions, and increasingly in the upper middle market, the existing credit facility may limit the incremental facility to both a fixed amount (known as a "starter basket" or "free and clear basket") and an unlimited amount subject to compliance with one or more leverage ratios. The fixed amount will generally be no greater than 1.0× of consolidated EBITDA and will often have a "grower" component (see discussion on grower baskets below). Our data shows that 15.8% of traditional middle markets deals with incremental facilities contain a starter basket for the incremental facility equal to or greater than 1.0× of consolidated EBITDA, compared to 37.5% from 2017. The unlimited amount will generally be subject to compliance with a leverage ratio. Depending on whether the original transaction is structured as a first lien/second lien credit facility or senior/mezzanine credit facility and what type of incremental debt is being put in place (i.e. debt *pari passu* to the first lien or senior facility, debt that is subordinate to the first lien or senior facility but *pari passu* with the second lien/mezzanine facility, or unsecured debt), the type of leverage test will be different (i.e. first lien leverage test *vs.* secured leverage test *vs.* total leverage test). In larger deals, the level of the ratios will often be set at the closing date leverage multiple or, in the case of unsecured debt, sometimes 0.25× to 0.50× outside the closing date leverage multiple. There may be an alternative test in larger deals for the incurrence of incrementals to the extent the proceeds of such incrementals are utilised to fund permitted acquisitions. In such instances, the incurrence leverage ratio will be the leverage ratio of the borrower immediately prior to giving effect to such permitted acquisition. The upper middle market generally follows the larger deals in terms of how the incremental amount is capped.
- We have seen a continuing trend in the data in the traditional middle market to allow for both a starter basket and an unlimited amount, with 79% of traditional middle market deals in 2018 permitting both components of incremental facilities, compared to 62% in 2017. In the traditional middle market, it was common for the unlimited incremental amount to be subject to an incurrence leverage test as well as *pro forma* compliance with the maintenance financial covenants. However, our data has shown that including a requirement that the borrower be in *pro forma* financial covenant compliance in connection with the unlimited incremental amount has become rare. In some instances in the traditional middle market where the incremental amount is subject to a fixed cap amount, our data also shows that the incurrence of incremental debt under the fixed cap will be subject to an incurrence leverage test (and even less frequently, a *pro forma* compliance with the maintenance financial covenants in addition to such leverage test).

  Borrowers prefer to craft incremental provisions so that different leverage tests are used as a governor to incur different types of debt (i.e. first lien debt, second lien debt or unsecured debt). This approach creates significant flexibility for a borrower, in that it allows a borrower to incur multiple layers of debt in excess of the overall total leverage test originally used as the leverage multiple. For example, in computing a total leverage ratio, the indebtedness included in such a calculation would typically include all funded indebtedness of the applicable credit parties and those subsidiaries included in the financial metrics of the credit parties. The indebtedness included in calculating a first lien leverage ratio would be limited to funded indebtedness subject to a first lien on the assets of the credit parties. As a result, a borrower could (I) first incur unsecured indebtedness up to the total leverage ratio cap, and (II) second incur additional first lien indebtedness up to the first lien leverage ratio cap. In this example, the second incurrence of debt would bust the total leverage ratio cap but this would not prevent the incurrence of first lien debt because the first lien leverage ratio does not include the unsecured indebtedness previously incurred by the borrower. This flexibility, although provided in the upper middle market, is often rejected in the traditional middle market transactions. Traditional middle market deals will usually only apply a total leverage ratio test for all types of incremental loans (or will apply a total leverage ratio test in addition to any other leverage based test that may be applicable to the incurrence of a certain profile of incremental debt).
- In large cap and upper middle market transactions, borrowers will also seek the ability to (a) elect to use the ratio based unlimited incremental amount prior to the fixed amount, (b) reclassify (at their discretion or automatically) incremental debt which was originally incurred under the fixed amount as incurred under the ratio based unlimited amount (thereby reloading the fixed amount), and (c) in instances where an incremental loan is incurred based on both the fixed amount and the unlimited amount, not take the fixed amount into account when testing leverage. In the instances where a traditional middle market financing allows for both a fixed starter basket and a ratio based unlimited incremental amount, historically the middle market lender has required that the fixed amount be used first and reclassification would generally not be permitted but that protection is beginning to erode as the reclassification concept moves down market.

- In large cap and upper middle market transactions, the incremental amount may also be increased, over and above the fixed starter basket and ratio based unlimited incremental amount, by an amount equal to: (a) in the case of an incremental facility that effectively replaces any existing revolving commitment terminated under the "yank-a-bank" provisions, an amount equal to the portion of such terminated revolving commitments; (b) in the case of an incremental facility that serves to effectively extend the maturity of the existing facility, an amount equal to the amount of loans and/or commitments, as applicable, under the existing facility to be replaced with such incremental facility; and (c) all voluntary prepayments of the existing term loans, previously incurred incremental term loans and refinancings of the existing term loans and voluntary commitment reductions of the revolving facilities (except to the extent funded with the proceeds from an incurrence of long-term indebtedness (other than revolving indebtedness)). The incremental amount limitations will be the same for incremental equivalent facilities provided that the establishment of an incremental facility or the incurrence of incremental equivalent debt will result in a dollar-for-dollar reduction of the amount of indebtedness that may be incurred in the other facility. In this regard, the upper middle market is generally consistent with the larger deals. However, the traditional middle market will again differ in that if any additional amounts increase the incremental amount, it will be limited to the voluntary prepayments of indebtedness or commitment reductions of the revolving facilities.

Rate and maturity

- Generally, incremental term loans: (a) cannot have a final maturity date earlier than the existing term loan maturity date; (b) cannot have a weighted average life to maturity shorter than the weighted average life to maturity of the existing term loans; (c) rank *pari passu* with the existing loans or junior in right of payment and/or security or are unsecured; (d) are not secured by any collateral other than collateral securing the existing term loans or guaranteed by any guarantors not guaranteeing the existing term loans; (e) participate *pro rata* or less than (but not greater than) *pro rata* with the existing term loans in mandatory prepayments; (f) have covenants and events of default substantially similar to, or no more favourable to the lenders providing such incremental term loans than those applicable to the existing term loans, except to the extent such terms apply only after the latest maturity date of the existing term loans or (sometimes) if the loan agreement is amended to add or conform to the more favourable terms for the benefit of the existing term lenders; and (g) if incremental equivalent debt is permitted, such incremental equivalent debt is subject to customary and satisfactory intercreditor arrangements. Some borrowers in larger deals have been successful in negotiating a carve-out from the maturity requirement which would allow the borrower to incur incremental term loans with earlier maturities, up to a maximum amount governed by a fixed dollar basket.

  These terms have generally been adopted in the upper middle market. The traditional middle market does not contain significant variations, except that the traditional middle market sometimes only allows the incurrence of incremental debt that is *pari passu* debt, contains additional restrictions on *pro rata* or less than (but not greater than) *pro rata* voluntary prepayments with the existing term loans and will not permit earlier maturities of incremental loans. Although it seems that allowing the borrower to incur either lien subordinated or unsecured subordinated debt instead of *pari passu* debt would be beneficial to the lenders, the traditional middle market's resistance to allowing different types of debt stems from a desire to maintain a simpler capital structure especially in credit transactions where there are no other financings.

- The interest rate provisions applicable to incremental facilities customarily provide some form of pricing protection that ensures that the all-in yield of the existing credit facility would be increased to match (less 50 basis points) any new incremental facility (to the extent *pari passu* in claim and lien priority to the existing credit facility) whose all-in yield was greater than 50 basis points above the existing credit facility. These provisions are generally referred to as the "MFN (most favoured nations) provisions". In large cap and upper middle market transactions, the MFN provision often contains a "sunset", meaning that the pricing protection is no longer applicable after a period of time. This period ranges from 12 months to 18 months (some with sunset periods as short as six months). The sunset provision, however, may be eliminated altogether or flexed out, depending on market conditions. As the ability to designate incrementals with different payment and lien priorities (or as incremental equivalent debt) has become commonplace in large cap and upper middle market transactions, borrowers generally request provisions that effectively erode MFN pricing protections, including (i) additional carve outs to the calculation of all-in yield for amounts that do not clearly constitute "one-time" fees (for example, OID and upfront fees), thereby making it easier to remain below the MFN trigger threshold, (ii) limiting the application of the MFN protection to the term loan facility originally issued under the credit facility, and (iii) excluding from the MFN provisions incrementals (or incremental equivalent debt) that (a) are incurred in reliance on the started basket amount, (b) are utilised for specific purposes (e.g., for permitted acquisitions), (c) are structured as an issuance of notes (whether issued in a public offering, Rule 144A or other private placement) as opposed to loans, (d) mature later than the latest maturity debt of any other term loans under the credit facility or which are bridge-financings, and (e) are within a certain capped amount. Without adding further protections, allowing the incurrence of an incremental loan based upon the starter basket amount to be free of the MFN protection has the potential of eliminating the MFN treatment altogether in deals where the borrower has the ability to redesignate starter amount incrementals as leveraged based incrementals because the borrowers are able to, in certain circumstances, reload the starter basket amount. Our 2018 data shows that only 9% of traditional middle market deals with MFN provisions include a sunset period, consistent with 9% in 2017, but increased from 3% in 2016.

  The traditional middle market takes a somewhat consistent approach to the upper middle market's treatment of the MFN provision. For the most part, *pari passu* debt issued in reliance upon the incremental provisions is subject to the MFN provisions. However, middle market lenders may also require that the impact of the MFN provisions apply to all debt outstanding under the credit facility, including incremental loans previously funded. Traditional middle market lenders in single-lender or club deals have had some success maintaining the MFN provisions without a sunset with exceptions generally limited to first lien transactions and senior stretch transactions where the credit is intended to be syndicated.

Use of proceeds

- In large cap and upper middle market transactions, proceeds from the incurrence of incremental and incremental equivalent debt may generally be used for any purpose not otherwise prohibited by the original credit facility. In contrast, the traditional middle market sometimes restricts the use of proceeds to very specific purposes such as acquisitions or capital expenditures. Our data shows a clear migration of the large cap and upper middle market flexibility with respect to the use of incremental proceeds filtering down to the traditional middle market. Increasingly, middle market lenders are permitting incremental proceeds to be used for general purposes, including for restricted payments such as dividends and payment of junior debt but subject to stricter leverage tests. As a result, limitations placed on the use of proceeds for incremental loans are mostly seen in lower middle market deals in today's market.

Ratio Debt

In addition to the incremental and incremental equivalent facilities described above, large cap and upper middle market transactions often include additional debt incurrence capacity through the inclusion of "ratio debt" provisions. These provisions can be traced back to the high-yield bond market. Ratio debt allows a borrower to incur additional indebtedness so long as the borrower meets the applicable leverage ratio or interest coverage ratio test. If this debt is leverage-based, the ratio is typically set at the same level required for incurrence of incremental and incremental equivalent debt. In upper middle market transactions that include ratio debt provisions, the conditions for incurrence (other than the applicable leverage or interest coverage test) may be looser than the conditions to incurrence of incremental and incremental equivalent debt, though lenders have had some success in standardising the conditions across the different types of permitted debt incurrence. To the extent ratio debt provisions appear in traditional middle market transactions, the incurrence of such debt is often conditioned on such debt being subordinated in right of payment to the credit facility (and is not otherwise permitted to be secured). Additionally, where the traditional middle market allows for ratio debt, it requires that any applicable MFN provisions be applied to any ratio debt that is *pari passu* to the credit facility obligations. Notably, this middle market term has migrated up market as upper middle market deals have increasingly adopted this protection in respect to ratio debt. Lower middle market transactions generally do not provide for ratio debt. Our data shows that 41% of traditional middle market deals permitted ratio debt, compared to 48% in 2017.

Acquisition Indebtedness

Generally, credit agreements will allow the borrower to incur certain indebtedness in connection with a permitted acquisition or investment. Not surprisingly, the larger deals will commonly allow the borrowers the most flexible formulation and permit the incurrence of any acquisition indebtedness, provided that it is only the obligation of the entity or its subsidiaries that are acquired. The upper middle market takes a similar (but more restrictive) approach to the large cap market and will sometimes provide that, after giving effect to the acquisition indebtedness, the borrower must be in *pro forma* compliance with the financial covenants and/or meet a leverage test (i.e. closing date leverage). Although it is not uncommon for this type of indebtedness to be permitted in the lower middle market, it will be subject to additional limitations, including required subordination terms and dollar caps. In lower middle market deals, there is still a preference for allowing acquisition indebtedness to the extent it is subject to a dollar cap.

Limited Condition Transactions

One of the best known outcomes of the loosened credit markets in 2005 was the "certain funds provision" technology proposed by sellers who gave preference to those potential buyers who had financing locked down. Certain funds provisions (also commonly known as the SunGard provisions) provide that, except as expressly set forth in a conditions annex to the commitment papers, there can be no other conditions precedent to the closing and funding of the credit facility in the definitive loan documentation, and it limits the representations and warranties required to be true and correct at closing to certain material representations set forth in the acquisition agreement that give the buyer or its affiliates a right to terminate the transaction (the "acquisition agreement representations") and a narrow set of additional "specified representations". It also limits the actions required to be taken by a borrower pre-closing to perfect security interests in the collateral to certain essential actions, with all other actions to be taken on a post-closing basis. The certain funds provisions were designed to assure buyers and sellers that, so long as the conditions to closing under the acquisition agreement were met, the lenders would not have an "out" beyond a narrow set of conditions in the conditions annex.

Acquisition financings in general, regardless of the market, have generally adopted the SunGard provisions which require that the only representations and warranties at closing that are conditions to closing and funding loans are "specified representations" and the acquisition agreement representations. All other representations and warranties in the credit agreement are made at closing, but their truth and correctness are not conditions to closing. Even if such representations and warranties are not true and correct, the lenders will be required to close the financing, but with a default immediately following the closing. In most competitive deals, the borrower will seek to limit the representations and warranties made only to the specified representations and the acquisition agreement representations so that even if the other representations are not true, the borrower will not have a default post-closing. The upper middle market has generally followed the larger deals in this respect but not without objection, especially in first lien and second lien financing transactions where the second lien lenders will not benefit from a regular bring down of the representations by way of the conditions precedent to borrowing under a revolver. The traditional middle market, for the most part, continues to resist the requirement that only specified representations and acquisition agreement representations should be made at close.

As borrowers continued to push for greater flexibility in credit documents, the certain funds provisions continued to evolve, widening its applicability to include future acquisitions financed from the proceeds of incremental loan facilities or ratio debt. As this becomes applied more broadly, limited conditionality with respect to conditions to borrowing incremental debt primarily to finance a limited condition acquisition has become customary. These features provide a borrower comfort that financing for follow-on acquisitions will be available. In larger deals, borrowers have been successful in extending this "limited condition acquisition" protection to all acquisitions using an incremental facility, regardless of whether there is a financing condition in the underlying acquisition documentation. Currently, the applicability of the certain funds provisions has been further broadened to include not only future acquisitions but also other investments, paydown of indebtedness, and restricted payments. Within the middle market, only the lower middle market still shows resistance to the broader applicability of the certain funds provisions.

Customarily, as noted above, conditions to incremental debt and "ratio debt" incurrence have included material accuracy of representations and warranties, absence of default or event of default, and in certain areas of the market, either a *pro forma* compliance with the existing financial covenant (if any) or meeting a specific leverage test, each tested at the time of incurrence of the incremental debt. Limited condition acquisition provisions enable a borrower to elect the signing date (also known as the "effective date") of the acquisition agreement ("acquisition agreement test date") as the relevant date for meeting the required conditions. As a result, if the borrower made such an election then the combined conditions to accessing the incremental loans and making a permitted acquisition (which may have included accuracy of representations and warranties, no events of default, and leverage tests) would be tested at the time the acquisition agreement is executed, with a subsequent no payment or bankruptcy event of default test upon the consummation of the transaction, and the borrower would have the ability to include the financial metrics of the target entity (i.e. EBITDA) at the time of such testing. Although the middle market has largely incorporated the limited condition acquisition protections, some lenders in lower middle market deals continue to push for a requirement that the relevant acquisition close within a specified time frame from execution of the purchase agreement (usually not longer than 180 days), otherwise the limited condition acquisition protections fall away. As a result, in the event the acquisition does not close within the agreed-upon time frame, the limited conditionality is eliminated and the borrower would have to comply with all the conditions at the time of the incurrence of the incremental loan.

The limited conditionality provision permits a borrower to elect the effective date of the acquisition agreement (or the date of the agreement documenting an investment, paydown of indebtedness or restricted payment) (instead of the closing date) as the date of determination for purposes of calculating leverage ratios in order to test ratio-based incremental debt capacity (as well as other incurrence tests described below). Testing the leverage ratio at signing eliminates the risk of a decline in consolidated EBITDA of the borrower and the target between signing and closing (the period between execution of the acquisition agreement and closing date referred to as the "Intervening Period"), when the ratio would otherwise be tested. This risk is of special concern in deals involving a lengthy delay between signing and closing due to regulatory approvals.

As the leverage test is intended to include the financials of the acquisition target on a *pro forma* basis, borrowers have further requested that any other incurrence based leverage test (required in connection with any other investment, incurrence of debt, restricted payment etc.) that is tested during the Intervening Period include the financials of the acquisition target on a *pro forma* basis. Generally, the markets have responded to this request in three different ways:

- *Most Borrower Favourable*: In large deals, any leverage test required during the Intervening Period will be tested after giving *pro forma* effect to the acquisition. In the event the acquisition does not close, any leverage test applied during the Intervening Period will be deemed to be valid regardless of whether the borrower would have failed to meet the leverage test without giving effect to the acquisition target's EBITDA. The upper middle market has not yet fully embraced this calculation of the leverage test, although we are seeing this construct more frequently.
- *Most Lender Favourable*: Any leverage test required during the Intervening Period will be tested on a stand-alone basis. The traditional middle market and the upper middle market (but less frequently) will generally take this approach.
- *Compromise*: The maintenance financial covenant and any incurrence leverage test pertaining to the payment of restricted payments (including junior debt payments) are tested on a stand-alone basis but the remaining incurrence leverage tests are tested giving *pro forma* effect to the acquisition. Another compromise is to test all maintenance financial covenants and incurrence leverage tests on both a *pro forma* and stand-alone basis. This application of the leverage test is often seen in the upper middle market.

Available Amount Basket

Once the leveraged financing markets revived following the down turn of the financial markets in 2008–2009, the concept of builder baskets or the "available amount basket" seen in high-yield bond deals migrated into, and became prevalent in, the middle market. It is worth noting, however, that the lower middle market has not fully embraced the inclusion of available amount baskets. An available amount basket is also commonly referred to as a "cumulative amount" or a "builder basket". The purpose of an available amount basket is to give the borrower the ability to increase certain baskets in the negative covenants (i.e. investments, dividends and payment of junior indebtedness) without asking for a consent from the lender. The rationale behind lenders conceding to an increase in certain baskets in the negative covenants was an attempt to recognise and reward an increase in the borrower's profitability by permitting the borrower to deleverage its debt and permit the borrower the ability to increase baskets in the negative covenants that generally restrict cash outflow. Our data shows that 76% of traditional middle market deals include the available amount basket concept, compared to 81% in 2017.

The available amount basket will be generally constructed to be the sum of the following:

- *Starter Basket Amount*: A starting amount (commonly referred to as a "starter basket amount") which initially, unlike the incremental starter amount, was not necessarily based on a percentage of the borrower's EBITDA but was, instead, generally determined on a case-by-case basis (which amount may be further increased by a grower basket in the larger deals). Currently, the starter basket amount will often be 25%–50% of the borrower's EBITDA. Middle market deals (but less frequently in the lower middle market transactions) will often include a starter basket amount. Our data shows that 85% of traditional middle market deals with the available amount basket include a starter basket amount, compared to 94% in 2017.
- *Retained Excess Cash Flow or a Percentage of Consolidated Net Income*: Typically in larger deals, the available amount basket will include a percentage of consolidated net income in addition to the retained excess cash flow because the borrower will have quicker access to the consolidated net income. This is especially relevant in those transactions that close in the first half of a fiscal year since the borrower will not be able to build retained excess cash flow until the end of the following fiscal year. Upper middle market transactions will often use either retained excess cash flow or a percentage of consolidated net income. In contrast, the traditional middle market deals will more often include retained excess cash flow which, in addition to having limited accessibility, will most likely be defined in a manner that results in as little actual excess cash flow as possible since the borrower will be required to make a mandatory prepayment in an amount equal to a percentage of such excess cash flow. As a result, the borrower is incentivised to minimise the amount of excess cash flow generated.
- *Contributed Equity*: If the available amount basket is included in the financing, then having it increased by the amount of equity contributions that are not otherwise applied under the credit agreement will be common regardless of the size of the deal. It is also commonly accepted that equity contributions made in connection with equity cures will be excluded from the available amount basket.
- *ROI on Investments Made With the Available Amount Basket*: Larger deals and upper middle market deals will commonly permit an increase in the available amount basket by the amount of returns in cash, cash equivalents (including dividends, interest, distributions, returns of principal, profits on sale, repayments, income and similar amounts) or investments. However, not all traditional middle market deals will include returns in cash, cash equivalents or investments in the available amount basket. If included, they will only be permitted to the extent such investments were initially made using the available amount basket and in an amount not to exceed the original investment.
- *Declined Proceeds*: Declined proceeds from mandatory prepayments required to be made by the borrower will commonly be included in the calculation of the available amount basket regardless of the size of the deal.

- *Debt Exchanged for Equity*: In larger deals, to the extent that any debt owed by the borrower is converted into equity, such amount will be included in the available amount basket. The upper middle market will often adopt this formulation while the traditional middle market has not fully accepted the addition of debt exchanged for equity in the calculation of the available amount basket.
- *Redesignation or Sale of Unrestricted Subsidiaries*: In larger deals and often in the upper middle market transactions, in the event an unrestricted subsidiary is (i) redesignated as a restricted subsidiary, or (ii) the subject of a disposition, the fair market value (generally determined in good faith by the borrower) of the investments in such unrestricted subsidiary at the time of such redesignation (in the case of clause (i)) or the net proceeds of such sale actually received by a restricted subsidiary or the borrower in excess of the original investment in such unrestricted subsidiary (in the case of clause (ii)), will increase the available amount basket so long as such investments were originally made using the available amount basket. The traditional middle market has not fully accepted this component of the available amount basket.

The conditions around the usage of the available amount basket vary greatly and the traditional middle market takes a very different approach than the upper middle market. As noted, the purpose of the available amount basket was to increase the baskets pertaining to cash leakage such as investments, dividends and junior debt payments. The upper middle market deals often place few conditions around the usage of the available amount basket. Such conditions may be further distinguished as follows. In most upper middle market transactions, conditions for accessing the available amount basket will usually apply in respect to a dividend or junior debt payment and such conditions may include no payment or bankruptcy events of default as well as a specific leverage test set at or within the closing date leverage level. In some cases, the specific leverage test will apply only to the extent the component of the available amount basket being accessed pertains to retained excess cash flow or a percentage of consolidated net income. In the more conservative upper middle market transactions and the traditional middle market deals, the approach will be to place conditions for the usage of the available amount basket for all investments, dividends and junior debt payments irrespective of which component of the available amount basket is being accessed. For the most part, these conditions may include a *pro forma* leverage ratio test as well as a no event of default condition. Additionally, in respect to the payment of dividends or junior debt, there will be an additional leverage ratio test that will be well within the closing date leverage (by as much as 1.0× to 2.0×).

Grower Baskets

Akin to the available amount basket, the "grower basket" is intended to provide the borrower with the flexibility of automatically increasing certain basket amounts based on the growth of the borrower's consolidated EBITDA or consolidated total assets. The middle market and, to a much lesser extent, the lower middle market, has generally adopted grower basket provisions (in certain circumstances, excluding baskets related to restricted payments and junior debt payments). Our data shows that 54% of traditional middle market deals include grower baskets in some form, compared to 63% in 2017.

Grower baskets are intended to be utilised at any time a hard capped amount is implemented. They are formulated as the greater of (i) a capped amount, and (ii) a percentage of either the consolidated total assets or consolidated EBITDA of the borrower. As such, grower baskets will be used in connection with the free and clear amount in incremental debt provisions, the starter basket amount in the computation of an available amount basket and other amounts set out as exceptions to negative covenants. In the upper middle market and traditional middle markets, certain transactions have incorporated exclusions with respect to baskets relating to restricted payments and junior debt payments from the grower basket concept, while still providing flexibility on baskets that are deemed to be accretive to the underlying business (such as investments).

Unlike the available amount basket, which represents an additional level of flexibility within the investments and restricted payment covenants by providing for an additional performance-based covenant exception, a grower basket is the addition of a growth component based on a percentage of EBITDA or consolidated total assets that corresponds to the growth of company. Utilisation of the grower basket will not be subject to any conditions such as there being no events of default or a leverage ratio test unless the exception for which the hard capped amount relates originally included any such condition.

Choosing between consolidated EBITDA or consolidated total assets is not exclusively beneficial to either the lender or the borrower. While EBITDA is better to measure the performance of companies that are not asset rich but are instead cash flow-centric, the downsides are that it can be volatile and, depending on the industry, very cyclical. Consolidated total assets, on the other hand, are better suited for companies that are asset-rich. However, the downside is that there may be certain assets that are difficult to value such as intellectual property and goodwill.

Unlike the available amount basket, which will uniformly build with a percentage of consolidated net income or retained excess cash flow, there is no established rate by which particular grower baskets are set. Instead, the parties will negotiate the hard-capped amount and set the percentage of either the closing date consolidated EBITDA or consolidated total assets to the equivalent hard-capped amount.

Unlike the calculation of the available amount basket which once increased would only decrease to the extent utilised, because grower baskets are formulated based on a "greater of" concept, if the growth component fluctuates in size, the quantum of the basket will also fluctuate (but limited down to the hard capped amount). Note, however, that since grower baskets are generally included in incurrence-based exceptions utilisation, if a grower reduces in size, any prior usage of the basket at the higher level will not trigger an event of default.

Looking Ahead

The Private Credit Group data reveals that, with each passing year, terms relating to debt incurrence, limited condition transactions, available amount baskets and grower baskets become more prevalent in the middle market as lenders adapt to the inclusion of what were once considered large cap terms. In 2018, our data demonstrated a slight slowdown in the adoption into the middle market of these large cap terms. Momentum was historically supported by evolving markets, the entrance of new capital and institutions into the middle market, a strong economy and fierce competition among lenders to place capital. We begin 2019 in the midst of a global economic slowdown and declining stock markets. Although the state of the economy remains uncertain and a potential economic downturn in US markets has been predicted by many economists, we expect many of these other historical factors to continue to impact the sustained migration of large cap terms into middle market transactions, to varying degrees based on the dividing lines of the lower middle market, traditional middle market or upper middle market. Recently lenders have achieved some success in flexing out more aggressive formulations of these terms during primary syndications of transactions. However, as these large cap concepts and provisions are adopted in the middle market, lenders' ability to unwind such change is, for the most part, limited. And as noted above, the growing use by borrowers and middle market lenders of credit documents from a prior transaction, or a precedent selected by the borrower, as the basis for the documentation of a new transaction should continue to solidify certain new concepts and provisions.

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Proskauer

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The Private Credit Group is a unique middle market finance practice. The breadth and diversity of our practice is unmatched in the industry. The group was the first to dedicate its practice solely to representing providers of private credit. We represent over 75 clients, including private debt funds, business development companies, asset managers, finance companies and family offices. These lenders provide financings for transactions ranging from $10 million to more than $1 billion across a myriad of product types and industries.

Secondments as a Periscope into the Client and How to Leverage the Secondment Experience

HSBC

Alanna Chang

Introduction

Law firms may be hesitant to lend a valuable associate to their client for an extended period of time, but failing to do so would be a short-sighted decision. A secondment at a client's office provides a law firm associate with an unfiltered lens into the day-to-day life of an in-house counsel. The secondment is an opportunity for the client and the law firm to strengthen their existing relationship and create new business opportunities. A financial institution's need for a legal secondee may arise from an array of reasons, ranging from the in-house legal team being short-staffed, the organisation having a special project ripe for a secondee or in-house lawyers going on parental leaves, sabbaticals or short-term assignments to other offices.

Even if the law firm associate has previously represented the financial institution on a transaction, transitioning from a law firm associate to a secondee will require some adjustments from how the secondee is accustomed to working on transactions and interacting with clients. The experience of being a secondee can be both challenging and rewarding. The associate will gain insight into the needs and demands of the in-house lawyer, as well as the priorities and risk profiles of the client. The secondment provides a unique opportunity for a law firm and its associate to distinguish themselves from other law firms and counsels and make their role as external counsel invaluable.

To provide not just the in-house lawyer's perspective on secondments, Will Clark, a corporate associate in the capital markets practice at Latham & Watkins LLP, and Katherine Stevens, a securitisation associate from Mayer Brown LLP, have also shared their experience as secondees at global financial institutions.

What are the Differences between Working at a Law Firm and Working In-House?

> *The structure of the group and the volume of transactions. At Latham, I will generally work on a deal with one or two partners, and another counsel and/or associate. The work gets delegated accordingly, and we're all working essentially on the same issues and toward the same goals. In-house, I would generally be the only lawyer involved on a given deal, at least initially. In-house legal departments are fairly flat, which means that I took even my most basic questions to a senior person. I enjoyed working in this structure because everyone was happy to help and understood the learning curve for certain issues you experience for the first time in-house.*
>
> *At Latham, I almost always work on matters from beginning to close and thus have a solid understanding of the facts and the various parties involved. As a secondee, I could get a dozen one-off questions in a day about deals I may not have been involved with previously, and you have to learn how to get up to speed quickly. It takes a while to get accustomed to reviewing documents with a more high-level focus and leaving minor drafting issues, things you are trained to catch and fix at a firm, to your external counsel. You have to focus on the most important issues presented and move on to the next deal.*
> – Will Clark

As most in-house lawyers have a legal specialisation and their work is focused on a particular coverage area or sector within the financial institution (even if other in-house colleagues share the same specialisation), the secondees will, in turn, enjoy far more autonomy compared to their counterparts working at law firms. Given the high volume and pace of the transactions, the secondees will also need to work independently with oversight from a supervising in-house attorney.

Inherent to the in-house counsel role, which necessitates high-level involvement in a transaction, secondees will have visibility into and engagement in multiple transactions at once – differing from a law firm associate who typically handles one or two large transactions at a time from the transactions' inception to their closing. This provides secondees with a strong pulse indicating the market standard. If a new regulatory or legal change comes into effect during the term of the secondment, the secondee may get to participate in discussions between in-house lawyers and external counsel to understand the legal responsibilities for the financial institution, how the market is responding and what the new market practice will be. The secondee will also be involved in the internal discussions to understand the impact of such new changes on the financial institution and obtain an appreciation for the financial institution's specific concerns or risks resulting from such changes. For example, recent regulations where secondees may have seen the evolution of market standard provisions include the Financial Crimes Enforcement Network's beneficial ownership rule, the amendment to Delaware's Limited Liability Company Act enabling limited liability companies to divide into two or more new limited liability companies, and the qualified financial contracts stay rules issued by the U.S. Board of Governors of the Federal Serve System, the U.S. Federal Deposit Insurance Corporation and the U.S. Office of the Comptroller of the Currency.

Unlike an associate's traditional role of facilitating and executing transactions, secondees will be expected to be on the forefront of understanding and implementing regulatory changes affecting their practice area and to help oversee that the transaction documents effectively address new legal concerns affecting the financial institution. In a law firm environment, the secondee may occasionally get the opportunity to work on regulatory and market changes, but when working in-house, the secondee will have a voice in shaping the legal provisions in transaction documents to address any liabilities or responsibilities arising from these new legal requirements.

> *At a law firm, I would typically split my days working on the details of five or six different transactions. In-house, on a busy day I could have up to 10 to 15 deals that I was actively working on at one time. It's impossible (and not a good use of your time) to do the same type of review on those transactions as I would at a law firm. It's important to discuss what the detail and scope of your review should be with the in-house lawyer you are replacing or another member of the team to ensure that you are providing the business with a different perspective than the outside counsel on the transaction. In addition, think carefully about the questions that you receive from the business. As an associate in a law firm, the questions clients ask will generally be legal questions that can usually be answered by reading the related statute or regulation. However, as an in-house lawyer, the answers to a number of questions I received dealt with what the policy of the company was in a particular instance, as opposed to a question of law. Don't be afraid to run a question by another member of your team if you think it may touch on a company policy.* – Katherine Stevens

In-house lawyers provide guidance and legal advice when the financial institution is making high-risk decisions, accepting off-market terms or making reputational decisions and are seen as the institution's "risk stewards", whose role is to moderate between legal liability and risk. Unless a transaction is of high-risk to the bank, whether due to financial, reputational or political risk, or if the transaction is an inaugural product or platform, in-house counsel and secondees will rely on external counsel to negotiate the finer business points of the transaction. Secondees, in turn, will be focused on ensuring that the legal issues specific to that financial institution are identified and protected. For a regulated United States depository bank, these legal issues may include Regulation U, Regulation W, margin lending concerns, cross-border lending and licensing requirements, leveraged lending guidelines, and sensitivities to sanctions and anti-bribery and corruption matters. If the law firm leverages the secondee's knowledge gained from the secondment, the law firm could use that information to provide in-house counsel with an extra level of legal service tailored specifically to that client's needs that can help distinguish that law firm from its competitors.

What Did You Learn as a Secondee?

> *Working as an in-house lawyer is a great way to learn more about how a company/bank operates and more about the business teams. In-house attorneys are able to build a different relationship with the business teams than lawyers at law firms. I was able to sit on the trading floor and work face to face with the business teams and listen in on business calls that lawyers at law firms are not usually invited to. I was also able to meet the business one-on-one for coffee and get to know them on a personal level and solicit feedback on what I could do to help them. You learn what really drives a business as a whole and what drives the teams you are supporting. Finally, as you learn the differences between being an associate at a law firm and an in-house lawyer and experience a day in the life of the latter, you learn what is helpful and not helpful from outside counsel. I am better able to serve my clients, especially in-house lawyers, because I spent time as an in-house lawyer myself.* – Katherine Stevens

> *I learned a lot about the way a bank actually works, in terms of operations, the way the teams are structured, and just the general dynamics. I represent underwriters at Latham so I'm familiar with the different bank teams on my deals, but when you are in-house you actually see what people do on a day-to-day basis. There are other teams that I have seen on countless working group lists that I had never actually interacted with before, so I got to experience those aspects for the first time. I sat on the trading floor occasionally and that was very illuminating – sitting face-to face with the teams that I had been supporting and being privy to conversations I wouldn't otherwise hear. Because I worked closely with the head of legal for the group where I was assigned, I was able to be a part of conversations that happen when an idea is just being contemplated and before any deal is even structured. This included the business teams calling legal to ask if they can do a deal in a certain way, what issues that would present or what alternatives could be considered. As a junior associate, I'm usually coming in to implement and execute a general deal structure that has already been decided. Now I think I have a more holistic view of the work now having been on both sides, and a lot of perspectives from being in-house that I think will be helpful in understanding the needs of clients as an associate.* – Will Clark

During the secondment, secondees are folded into many of the same daily activities as permanent in-house lawyers. This grants the secondee a chance to learn about the business and their long term goals, which other external lawyers rarely have access to. Law firms are typically engaged for a specific transaction, project or request for legal advice. However, often there is usually a broader initiative or focus for the financial institution that goes beyond any one specific transaction, whether the aim is to grow a particular line of business, offer a new type of product or pivot from its current strategy and sell its holdings. External counsel usually only has a granular, engagement-by-engagement view of its client; however, the secondee's access to the business team and ability to participate in internal discussions allow the secondee, and in turn the external law firm, to piece together the client's business roadmap. Does the client have a low-risk tolerance for a particular type of business that it now wants to exit? Is this one-off transaction viewed internally as a successful transaction and is the client seeking new mandates in this area? By knowing the answers to these questions, the law firm can be better prepared and placed to suit its client's needs and to mirror its client's directional movements.

How Can Law Firms Leverage the Secondment Experience?

By being physically located in a client's offices, the secondee has the ability to gain access to important information about that client, its business, its structure and its top priorities and risks that others would not be privy to or that would be difficult to extract. Once integrated into the team, the secondee will readily understand and have visibility into the client's various lines of business and its structure. Within a large financial institution, these different areas include trade finance, asset finance, leveraged and acquisition finance, debt capital markets, derivatives, mergers and acquisitions, project finance and trust and corporate services and cash management. In turn, this allows the law firm to understand the client holistically and to potentially gain a foothold in building new relationships within the client.

With each new introduction to his or her in-house counsel colleagues, the secondee has the opportunity to convert these connections into potential business opportunities. By simply engaging in everyday social interactions with the other in-house counsels, whether at the water cooler or at a legal luncheon, the secondee will be networking and forging new relationships on behalf of the law firm. These meaningful relationships between the law firm and the in-house counsels can lay the groundwork for new avenues of growth, for both parties.

The secondee will also learn highly sensitive information about the selection of external counsel by the very nature of performing his or her role of reviewing transactions and working on projects for the client. For each transaction, the secondee will work with different external counsel representing the client, which in some cases may be the law firm's direct competitors. The law firm will learn about the other law firms that the client hires and may come to understand the rationale behind the client's law firm selection process, including whether this is driven by existing relationships, pricing, legal expertise or some other factor.

In an environment where competition between law firms is fierce, the added insight into a client's structure, lines of business and operations provides the secondee, and his/her law firm, with valuable information, perspective and insight that enables both the secondee and the law firm to better meet and serve the client's unspoken needs and demands and to become a trusted advisor to the client. The ability to understand internal processes and see the client as a whole allows the law firm to strategically market its services and serve as a "partner" to the client. For strategic reasons, financial institutions are pushing to consolidate their use of external law firms. The more embedded a law firm becomes into the various lines of business, the better the law firm understands how internal processes work, and the more that a law firm is aware of the client's specific legal sensitivities. With these factors aligning in favour of the law firm, in-house counsel has a stronger and more compelling argument when advocating for that law firm to remain on its panel and as its preferred law firm.

Conclusion

A secondment to a client provides the secondee with the exclusive opportunity to forge a closer relationship with the law firm's client and to gain a deeper understanding of a client's sensitivities and concerns through daily interaction with the business and in-house counsels and a firsthand view of the needs and demands of an in-house counsel. While the secondment provides the associate with the ability to work on transactions from a high-level, partner-like perspective by making risk-based decisions and overseeing transactions, it also provides the law firm with a periscope into the inner machinations of its client.

From the financial institution's perspective, the secondment provides much appreciated additional legal support to manage transactions and to complete internal projects. In addition, since associates are typically the party sending document distributions and the first line of response on communications, in-house counsel appreciate building a better relationship with these front-line associates and having an associate on their transaction that is both sensitive to their internal process and mindful of the same legal concerns as if he or she were an in-house counsel.

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HSBC

Trade Finance on the Blockchain: 2019 Update

Holland & Knight

Josias Dewey

1 Traditional Trade Finance

The Primary Driver of Global Economic Growth

We have updated last year's discussion of blockchain and trade finance to address several projects, joint ventures and other significant advances made toward digitising the global trade engine. 2018 saw several industry participants move from pilot programmes to efforts on commercial projects. Some of the new projects and announcements for 2018 included: the Department of Defense's decision to deploy a blockchain on SIMBA's protocol; Eximchain raised $20 million in funding for a supply chain solution; and Maersk and IBM's joint venture, TradeLens, continued to gain supporters. There are also discussions about new thoughts on matters of policy and trade that gained traction during the last year. With approximately 80–90% of global trade reliant on trade finance, it is estimated that the industry is worth nearly $10 trillion a year.[1] The evolution in trade finance is being driven by greater efficiencies and novel capabilities resulting from advancements in the underlying logistics of the global supply chain, all of which are being made possible by the combination of three powerful technologies: (1) blockchain and distributed ledger technology; (2) the Internet of Things ("IoT"); and (3) powerful machine learning-capable cognitive tools (e.g., IBM's Watson) that are capable of analysing vast amounts of data that humans simply can't do.

The transformation occurring in supply chain management and trade finance is not simply about converting from paper documents, such as letters of credit and bills of lading, to electronic documents. To the contrary, as we will discuss in detail, the changes that are occurring are about new ways that participants in supply chains can share information in a very granular and controlled manner, utilising novel technology that allows economic participants to trust the outcome of transactions without any need to trust the actual counterparties to a transaction. Equally important is the ability of distributed ledgers to accomplish the foregoing without the need for a trusted third party to act as an intermediary for the transaction – disintermediation has become a key theme of distributed ledger technology, and supply chains and the trade financing vehicles that keep them operating are not exempt from this phenomenon. The industry has come to see the technology as being one that allows for automation on a scale not previously possible.

What is Trade Finance – Basic Mechanics

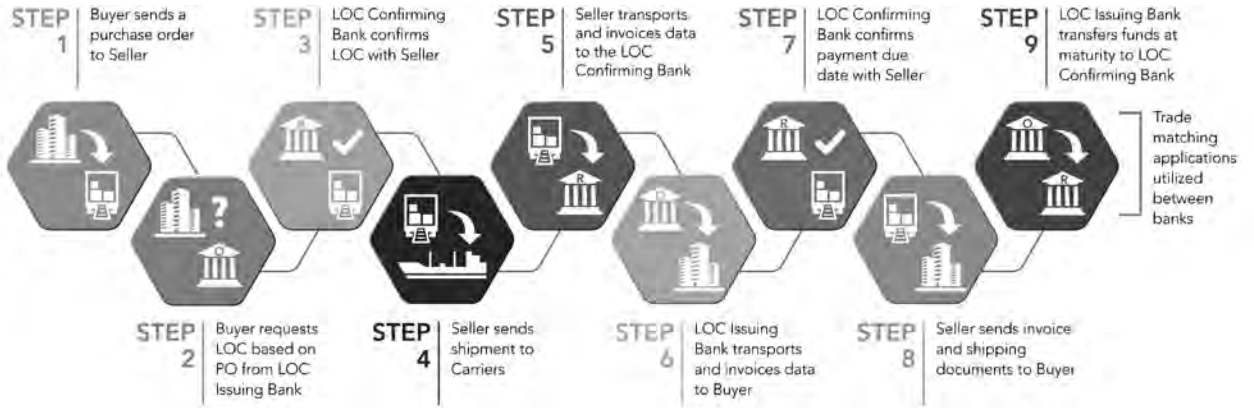
Before discussing the future of trade finance, it's important to understand the current mechanisms used to facilitate the movement of goods and commodities across the globe – much of which has remained static over the last few hundred years. It did not take human civilization long to discover the benefits of specialisation and trading resources that might be prevalent in one geographic region for other goods which are scarce in the same region. In the beginning, bartering ruled most forms of trade and even after stores of value, such as gold, allowed for the acquisition of goods for money, marketplaces were often static in terms of point of sale – thus requiring trading groups and companies to venture across long and often dangerous trading routes. With the advent of oceanic shipping, however, it became far easier to move large quantities of goods and commodities from one port to another far more efficiently.

While a superior approach in terms of economic efficiency, "chicken and egg" situations soon arose when sellers did not want to place their goods on a ship for delivery to the purchaser without payment; and likewise, buyers did not want to pay for goods that they had not received – enter trade financing solutions. In its most simple form, trade financing addresses the "chicken and egg" dilemma by effectively creating an intermediary, such as a bank who issues a merchant letter of credit, who can assure the seller of payment if the seller performs and protect the buyer from ever paying for undelivered or non-conforming goods. In most circumstances, this is accomplished by the buyer causing its bank to issue to the seller a merchant letter of credit in the amount of the purchase price for the goods. The bank who issues the merchant letter of credit generally requires that the seller present, together with the merchant letter of credit, documentary proof that conforming goods were delivered to the buyer and that the seller has met the conditions to payment. One of those conditions will be the delivery of a properly executed bill of lading (a document of title) to the buyer, who with that and an opportunity to inspect the goods to ensure conformance, is never at risk of losing his or her capital in the event of the seller's nonperformance.

It should be apparent that, in many respects, the "finance" transaction described above has less to do with loaning money and extending credit and more to do with facilitating a transaction that might otherwise introduce too much risk for the buyer, seller or both. There are plenty of trade finance transactions that are akin to more traditional extensions of credit. For example, a farmer may need trade finance to acquire seeds and fertiliser and is unable to repay such financing until the farmer harvests his crop. In that case, the transaction could be solely driven by credit considerations. In some cases, trade finance serves both as a transaction facilitator and an extension of credit necessary to provide a farmer or manufacturer with inputs necessary to generate the profits necessary to repay the extension of credit. In the case of the farmer, the seeds and fertiliser may be shipped from a foreign producer, such that the trade finance solution serves both purposes – the role of an intermediary with respect to the exchange between the farmer and the foreign producer and that of an extension of credit because the farmer lacks the liquidity to purchase the inputs necessary to grow his crop.

Trade Finance – Traditional Lifecycle

While there are several forms of trade finance, we have chosen to further illustrate, via graphical illustration (which the author admits is an oversimplification with respect to many transactions), the mechanics of this industry through one of the most conventional types of trade finance facilities – a merchant letter of credit:



As entire books are frequently written on trade finance, we can't analyse the above transaction from every participant's perspective in a single chapter. So, we will look at some of the most common pain points and areas of "friction" from the perspective of a bank or other financial institution providing trade financing in a transaction following the lifecycle depicted above. In any secured transaction, a trade finance lender will want to ensure that its position:

(i) is adequately collateralised (i.e., the seller has the goods it purports to have or will have when it is required to tender and the value of such goods is consistent with the assumptions made by the lender in underwriting the credit);

(ii) consists of a first-priority security interest (unless providing subordinate financing); and

(iii) is consistent with its understanding of risks posed by acts of god, casualty or other *force majeure* events, and that such risks have been mitigated by insurance or other means to the extent available.

To achieve the above three objectives, lenders often employ the following "controls":

(i) implementing relevant financial controls throughout the trade transaction lifecycle;

(ii) monitoring all material aspects of the transaction; and

(iii) ensuring that the collateral (i.e. the trade goods) are properly stored and transferred.

Using the bill of lading example illustrated above, implementing these controls can be a cumbersome and fragmented process for lenders, which often lead to the following "pain points":

(i) Fraud. Current methods of documentation, and documentation transfer, do not protect against the risk of parties, including lenders, relying on falsified documentation.

(ii) Tracking and Reconciliation Costs. Current fragmented trade lifecycles, which require human involvement and interaction throughout, require constant tracking and reconciliation by lenders and often require that such be done amongst several different platforms.

(iii) Authenticity of Goods. A lack of uniform tracking mechanisms from "source to sale" provides susceptibility for counterfeit goods to enter the trade lifecycle.

(iv) Confidentiality. The current necessity to (humanly) verify and reconcile points throughout the trade cycle make it difficult to ensure the confidentiality of the trading parties and terms.

It should come as no surprise that the above complexities often leave bank customers less than satisfied with the overall experience of obtaining the credit. To make matters worse, there has been a steady increase in transaction costs, in part, due to the increasingly difficult regulatory environment. Fortunately, all participants may soon be receiving relief from all of the above.

Trade Finance – Increasing Number of Stakeholders Means Growing Complexity

It is also worth noting that some of the additional friction in the market today is due to an increase in the overall number of persons involved in the process, including trade finance credit insurers, customs personnel and certification organisations, who – depending on the existence of friendly trade arrangements – may be required to hold the goods at port or other locations for extended periods of time. This increase in participants has led to a corresponding level of complexity. Simply put, supply chain management and trade finance have become more complicated, while innovation was non-existent. Seemingly overnight, the paper documents that remained in use for decades are on the verge of extinction.

2 Emerging Technologies – Blockchain Technology

Blockchain technology is commonly defined as a decentralised peer-to-peer network that maintains a public, or private, ledger of transactions that utilises cryptographic tools to maintain the integrity of transactions and some method of protocol-wide consensus to maintain the integrity of the ledger itself. The term "ledger" should be thought of in its most simple terms; imagine a simple database (like an Excel spreadsheet) that can store all sorts of information (e.g., someone's name, age, address, date of birth). As you can write an entire book on the topic of blockchain technology and the law (I know because I did), set forth below is a very cursory review of the underlying technology. If you are not comfortable with the technology itself after reading the below, there are no less than a couple of hundred good descriptions available on the Internet (or you can find my book).

Blockchains tracking the transfer of virtual currency, such as Bitcoin, essentially maintain a ledger that tracks the transfer of Bitcoin from a transferor to a transferee. Perhaps most importantly, such ledgers are considered decentralised because transactions are stored on several thousand computers connected to a common network via the Internet. These computers are known as "nodes". Each node contains a complete history of every transaction completed on a blockchain beginning with the first transaction that was processed into the first block on that blockchain. This network of nodes is connected via the Internet, but in a completely decentralised manner (i.e., there is no single server to which all the nodes are connected). So, when we refer to the network, this describes all the peer-to-peer nodes operating under the same set of rules (commonly referred to as a "protocol"), which are embodied in computer code under which all participants in such blockchain operate. Thus, at the heart of every blockchain is an agreed-upon protocol that ensures that only information upon which the network reaches consensus will be included in the blockchain. In other words, a network of computers, all running a common software application, must come to agreement upon whether a change to the blockchain (again, think "ledger") should be made, and if so, what that change should be.

As a proposed transaction propagates throughout this peer-to-peer network, there is still one last step left to consummate the transaction – the transaction needs to be memorialised into a block on the given blockchain ledger. "Blocks" are simply a convenient way of aggregating transactions into larger groups (or batches) for processing purposes. The perceived immutable nature of the ledger is rooted in the aggregation of time-stamped transactions into linear sequenced blocks. It is the aggregation into blocks that permits us to create links between transactions – the proverbial "chain" in the blockchain. Each block contains a reference to the block before it. This resulting relationship between all the blocks makes it exponentially more difficult to alter a prior entry in the ledger. Recently, certain protocols have been developed which have all the character of a blockchain, but without the block structures – hence the reason all blockchains are distributed ledgers while not all distributed ledgers are blockchains (e.g., R3's Corda platform is not a blockchain). For the time being, the terms distributed ledger technology and blockchain are generally used interchangeably – the reader should recall the distinction, however, is dealing with the implementation of a distributed ledger system that requires a blockchain-style ledger.

While Bitcoin was the first implementation of blockchain technology (and the only implementation for several years), with the advent of the Ethereum protocol and the subsequent "Blockchain 2.0" protocols, the capability of the technology skyrocketed – as did the potential use cases. The reference to "Blockchain 2.0" generally refers to the development of smart contracts, which is executable computer code that is broadcast to all of the nodes connected to a distributed ledger – the resulting computation being what determines any changes to the ledger. While the term "smart contract" does not necessarily refer to a legally binding contract (but rather any snippet of code), some smart contracts do constitute legally binding agreements. The advent of smart contracts is critically important to its adoption for trade finance – without it, we would not be able to model the functionality and provisions of a letter of credit or bill of lading.

Another recent development that was necessary for distributed ledgers to play an active role in trade finance was the ability for parties to include all the details of a trade in the transmission of a transaction to a distributed ledger – but limit who can see which details with very fine control. For example, if a seller of crops experiences a liquidity crisis and must sell a portion of his crop for below market prices, the seller will want neither his competitors nor other buyers in the market to know the price for those crops. In this example, it is possible to broadcast the transaction with only the buyer and seller seeing the price and needing to validate the terms to the contract. Any other consensus on the network will be limited to the existence of the transaction itself (and most likely a time stamp as well).

While there are no less than a dozen protocols in regular use today, the two most public blockchains are Bitcoin and Ethereum. Anyone is free to connect to either of those protocols. Unlike public blockchains, most financial institutions and other enterprise users are not comfortable using public blockchains because of data security and privacy concerns, among others reasons. Instead, these institutions have or intend to deploy permissioned and/or private distributed ledgers, where each member of the distributed ledger knows with whom it is transacting. Again, there are many more protocols that are listed herein, but some of the more popular permissioned protocols are: (1) R3CEV's Corda platform; (2) Hyperledger Fabric (also hosted on IBM's cloud as its native blockchain solution); (3) Monax (formerly known as Eris); (4) Ethereum (permissioned version, Quorum, developed by JPMorgan); and (5) Ripple.

3 Emerging Technologies – The Internet of Things ("IoT")

Even alone, distributed ledgers would have a significant impact on supply chains and trade finance, but when coupled with two other technologies – IoT and Cognitive Analytics (including machine learning) – the impact will be nothing short of a paradigm shift. The Internet of Things (IoT) is one of the other technological advances that will have a major impact on the financial industries. IoT refers to the simple concept that more and more physical devices are becoming connected to the Internet (i.e., networked). Today, the types of devices being connected to the Internet are growing exponentially – both in terms of consumer and industrial products. For example, in January of 2018, Maersk and IBM announced the intention to establish a joint venture to provide more efficient and secure methods for conducting global trade using blockchain technology and IoT devices. The new venture aims at bringing the shipping industry together on an open global trade digitisation platform that offers a suite of digital products and integration services like transportation tracking systems.[2]

This trend is expected to continue over the next several years, such that virtually all physical objects in the world will be (or at least have the capability to be) connected to the Internet. These connections will work both ways. Physical objects will transmit information about their internal state and/or information about environmental factors (e.g., temperature, humidity). Many objects will also have physical actuators (i.e., things that interact with physical world such as motors, locks, LEDs). Together with sensors, this means that many physical objects will be able to transmit real-time information over the Internet (whether by ZigBee meshes, cellular or satellite transmissions) to applications that can analyse that data and send commands back to physical devices to interact with the physical world. For example, if a Maersk storage container's internal temperature is too hot, that data will trigger an application monitoring that information over the Internet to send a signal back to the container's internal fans to cool it down again.

Blockchain technology will augment IoT in several positive ways. First, blockchains built in cryptocurrency payment protocols are perfect for interacting with automated payment systems, especially in the context of complex trade cycles that do not necessarily require human interaction. Second, and probably more importantly, the blockchain can add a level of security that no other existing technology can. The distributed ledger is perfect for ensuring that use and ownership rights are adequately tracked. For example, the generation of public/private keys is perfect for ensuring that only an authorised user can authorise the dispatch or delivery of goods.

4 Emerging Technologies – Artificial Intelligence and Cognitive Analytics

Artificial intelligence and cognitive analytics, including applications leveraging machine learning, are the final ingredients needed to radically transform supply chains and trade finance. By combining distributed ledger technology with IoT devices, such as sensors, real-time data is available to the parties to the transaction and can be recorded on an immutable, tamper-proof ledger. This capability alone significantly improves the overall supply chain and trade finance process, but what about data from one or more business processes that requires intensive calculations or analytics that the human brain can't do? Artificial intelligence, especially the subsets known as machine learning and natural language processing, have made significant advancements in just the last couple of years. These tools can receive the raw data from the IoT devices, process the data and format it into useful structured data that can be used to monitor contract compliance matters. These tools remove any limitation on human cognition and traditional computing devices that impair our ability to process complicated and voluminous data sets. For example, Oaken Innovations and the Toyota Research Institute partnered to create a blockchain ecosystem of IoT devices that will support the future of autonomous cars. The infrastructure will accommodate voluminous, frequent, heterogeneous transactions like toll payments, peer-to-peer ride and car sharing arrangements and immediate insurance claims.[3]

In addition to real-time compliance oversight, artificial intelligence is also helping sellers and purchasers with business decisions that impact their entire enterprise, especially with respect to supply chain management. For example, price discovery is made possible so that a purchaser can unleash sophisticated algorithmic tools on massive amounts of data available online or through private network data feeds. Price discovery, however, is just the tip of the iceberg – a purchaser's entire inventory management process can be run by artificially intelligent machines, which can contract for supplies when appropriate without any human interaction. Machine learning capabilities are particularly useful because as these systems are used and provided feedback on the decisions they make, its performance or percentage of accurate decisions increases until it performs its function far better than its former human counterpart.

Of course, the real-time data feeds monitoring in-route products and the price discovery and inventory management are ultimately all part of one operation – to ensure the smooth and optimal purchase order and inventory life cycle. We must also keep in mind that these machine capabilities will continue to grow at a rapid pace, especially given the fact that Moore's Law appears to still have some run left in it before humans are no longer capable of fitting more transistors on smaller and smaller pieces of silicon. This assumes, however, that we do not discover entirely new ways to supply ever increasing computational power (e.g., quantum computing).

5 Trade Finance 2.0: Applying Emerging Technologies and Paradigm Shift

Any lawyer or professional who has practised transactional law for any length of time knows that the more stakeholders involved in a transaction or series of related transactions, the more difficult it becomes and the more "friction" is involved in the form of higher transactional costs and lost efficiency and output. Often, trade finance and supply chain transactions involve several stakeholders, especially when there is a cross-border aspect to the transaction. The number of participants can grow fast. Possible participants include the buyer, the seller, a letter of credit issuer (i.e., a bank), one or more correspondent banks, customs and revenue (tariff) officials, warehouse owner, logistics companies and a host of other possible involved participants. It is for this reason that distributed ledgers when combined with IoT devices and cognitive analytics prove to be one of the most powerful uses of distributed ledger technology.

The above means cost savings and reductions in transactional costs and friction in many cases are extreme. For example, the ability to model a merchant letter of credit in the form of computer code (e.g., Solidity, Java, Go); and more importantly, the ability of that code to execute on a distributed ledger using self-implementing conditions to, in the case of a letter of credit, release funds programmatically to the seller without any need for the seller to present a paper letter of credit to anyone. Consider the reduction in friction afforded by this mechanism. Rather than a paper letter of credit needing to work its way through a series of correspondent banks, each of which must be paid a fee, a digital letter of credit that is self-implementing executes automatically when the conditions to payment are met – resulting in a significant reduction of expenses.

Several months ago, BBVA applied blockchain technology to a letter of credit transaction between two offices in Mexico and Spain. Based on the trial, BBVA observed that the time taken to submit, verify and authorise an international letter of credit trade transaction was reduced from seven to 10 days, to just 2.5 hours.[4] In early 2019, the Singapore unit of Standard Chartered completed one of the first blockchain-powered trade finance deals on a platform developed by Distributed Ledger Technologies. Standard Charter previously helped develop, along with HSBC and others, eTrade Connect, a supply chain platform.

The inverse is also true, and no less important – meaning that the bill of lading, which evidences the transfer of ownership to the goods to the purchaser, is also transformed into computer code where it resides on a distributed ledger until payment is released to the seller. Upon payment, the bill of lading will automatically be released to the purchaser in digital form. This removes any issues with respect to fraudulently procured or produced documents of title, such as a bill of lading. In Q4 of 2017, ZIM, an Israeli container shipping company, announced it completed a pilot that used blockchain technology to carry out a paperless bills-of-lading. During the trial, all participants issued, transferred and received original electronic documents using blockchain technology, which managed the ownership of documents in order to eliminate disputes, forgeries and unnecessary risks.[5]

In addition to payments and documents of title, many more aspects (in fact, virtually all of them) can be converted to self-implementing code broadcast to a distributed ledger, together with corresponding, real-time contract administration and monitoring, including casualty insurance covering the goods during transit, foreign trade credit insurance and the coordination of any other logistics companies (e.g., last mile carriers).

In addition to what I will refer to as "core logistics", there are a host of other significant benefits to virtually all participants in the lifecycle of an average transaction, including integrity and providence matters. For the consumer, there is certainty that the product is what it says it is, whether that is assurances that a luxury brand is not a cheap counterfeit good, or that a non-GMO food product is in fact not made from genetically altered DNA. For governments, both taxation and import requirements are far easier to enforce when all of the data for products and manufactured goods flowing into and out of a country are monitored in real-time and stored in a tamper-proof, immutable ledger. Governments and regulators can easily require a "master key" with respect to goods and products over which they have some jurisdictional interest. For example, Walmart recently engaged in a pilot program to ensure the safety of produce sent to the U.S. from a foreign producer. It is for these reasons and many others that so much investment has been spent in supply chain and trade finance.

The benefits gained by the number of parties involved in the supply chain far exceeds the potential cost to implement.

It's important to appreciate that the concepts described in this chapter are not mere academic discussions or the thoughts of a futurist. To the contrary, everything has been implemented in real world pilot programmes, and some aspects are already in deployed, production systems. In fact, of all the potential use cases generally discussed as appropriate for distributed ledger technology, there is no other use case likely to reach critical mass in deployed, production-ready distributed ledgers. The world's largest participants in all aspects of trade finance and supply chain management are actively pursuing pilots and otherwise moving full speed ahead – these companies include Walmart, BNY Mellon, IBM, HSBC, Bank of America, Microsoft and Barclays, just to name a few. To be fair, the transition to Trade Finance 2.0 is not remotely finished and much of the supply management and trade finance are accomplished in the same manner as described in the very beginning of this chapter. The feedback, however, received from all the companies involved in pilot or prototype programmes has been unanimous – distributed ledger technology (as augmented by IoT and AI) will soon result in a complete paradigm shift.

While the promised land is in sight, there are still obstacles that must be overcome before all the world's trade is completed on distributed ledgers. Payment rails for the distributed systems currently under investigation are still not perfect. More specifically, unlike Bitcoin and Ethereum, Hyperledger Fabric (IBM Blockchain) and R3's Corda do not include a native cryptocurrency. These and other similar protocols do, however, support the creation of digital cash. For example, during 2018, R3 has made it a priority to explore the most efficient way to represent digital cash on a blockchain, including the establishment of a working group, consisting of several law firms, to explore regulatory and other considerations implicated by digital cash.

Maybe a more systemic hurdle to overcome is the lack of uniformity in the different distributed ledgers that are currently under active development. As discussed earlier, there are several different distributed ledger protocols under active development. These different ledgers can't currently communicate with each other, but this may, however, be a temporary impediment. Several development shops are working on interfaces and other strategies to achieve interoperability between these different ledgers. In addition, systems are being developed to ensure backwards compatibility for each new distributed system with existing legacy systems since it's not possible to transition the world's information technology systems all at one time. Furthermore, given the rather nascent nature of the technology, many companies prefer to overlay their distributed systems atop their legacy system to maintain a level of redundancy (what I refer to as the "training wheels" approach, which I believe to be a prudent approach).

While no one is certain of the exact timing, based on the current pace of advancement, it seems likely that there will be several deployed, production systems in operation within two to five years. Be sceptical of anyone who suggests these systems are 15 or 20 years away from production. In fact, if these systems are not in production before 10 years, that means they are likely never going into production and a newer, better system has surfaced (e.g., quantum computing). The reason for such a statement is that the potential benefits are so fundamental and so enormous when scaled on a global basis, that most major players in every industry imaginable are in a sprint towards implementation. The growing number of pilot programmes and proofs of concept appearing in the general news and economic journals is only further testament to the investment being made around the globe.

This rapid pace of development is likely to continue or even accelerate as industries reach critical mass – which triggers another key benefit of distributed ledgers, which is the mutualisation of the cost to implement new systems. Because distributed systems allow all participants to access a common truth, only one distributed ledger system needs to be designed and engineered to a common set of specifications and standards. Today, every participant maintains its own centralised database that is the subject of costly reconciliations with other counterparty records. For example, rather than 10,000 manufacturers in a province of China maintaining their own central database – as they do today – only one decentralised system must be operational; thus, resulting in each company paying 1/10,000th of the costs of such decentralised system. It's tempting to think distributed ledger technology is an area limited to the world's megabanks or largest retailers, like Walmart. The headlines certainly reinforce this perception.

For small to midsize banks, suppliers, manufactures and others involved in supply chain management and trade finance (or any other industry for that matter), distributed ledger technology is an opportunity to level the playing field and eliminate certain competitive advantages held by their larger competitors, especially with respect to the banking industry in the United States. Anti-money laundering (AML), OFAC and other compliance costs represent a disproportionate amount of expenses for small and midsize banks. Distributed ledger technology also can permit banks to mutualise the cost of compliance, and in doing so, improve the effectiveness of their overall programmes. This is just one of the many potential benefits (others include participation trading platforms) available to small and midsize banks. The choice seems simple. For those institutions willing to be innovative and to take some risk, there is an opportunity to be a trailblazer with potentially market-changing innovative solutions. For those who remain complacent and willing to allow the world's largest banks to maintain a monopoly on the future, their own future does not seem bright.

Perhaps the one force that can derail the implementation of distributed ledger technology across the globe is regulations or other policy enforcement that is too restrictive, and ultimately smothers out the innovation needed to reform our existing and inefficient processes. Fortunately, many jurisdictions, including the United States, already have existing legislation that, while passed years before distributed ledger technology existed, is broad enough in scope because of their origins out of the original Internet revolution. So, electronic or digital signatures, including public key infrastructure, are already accepted practice. While there will almost certainly be a need to tweak commercial laws here and there, especially in the cross-border context, those efforts should be easy to accomplish given the mutual benefits for all involved, including governments. The policy decisions that will impede distributed ledger technology are those too myopic on counterbalancing issues, such as consumer protection. Any policy that says no to any risk is a policy that will shutter innovation. Going forward, it is important that the regulators and policymakers both in the United States, the UK, continental Europe, China and the rest of the world's global trade powers, implement regulations and rules that foster innovation and encourage institutions to take chances to achieve potentially game changing results. That is not to say that financial institutions need a licence to engage in reckless activities, but rather enough flexibility to innovate by take calculated chances and risk. There is a balance that can be found where consumer safety and the soundness of the economic environment is maintained, while innovation fosters much-needed economic growth and employment growth around the globe.

Endnotes

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Joe Dewey is a financial services and real estate partner in Holland & Knight's Miami office and is considered a thought leader on blockchain technology. Mr. Dewey regularly represents banks and other financial institutions across the entire spectrum as measured by assets and scale, from community to global money centre banks. Mr. Dewey spends a considerable amount of time at the convergence of human prose legal contracts, as well as computational contracts, based primarily on computer code. This includes smart contracts that can be implemented on Hyperledger Fabric (or IBM's Blockchain service), Ethereum (both public and permissioned versions) and R3's Corda platform. Mr. Dewey spends a considerable amount of his practice in this space assisting clients in identifying optimal distributed ledger use cases and developing proof of concept applications. He can assist in the transition from proof of concepts (PoCs) to production systems built by our clients' primary technology solutions providers.

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The Global Private Credit Market: 2019 Update

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Introduction

2018 was another consecutive year of growth for the private credit industry globally. After ending 2017 with $667 billion in assets under management (AUM), private credit managers raised another $110 billion from investors in 2018. While slightly lower than the fund raising high-watermark of 2017, which saw around $130 billion raised, 2018 continued the trends that have seen private credit funds triple their AUM over the last 10 years and prompted expectations that in another 10 years, AUM for the industry will exceed $2 trillion. As we enter 2019 with close to 400 private credit funds operating in the markets, and undrawn capital, or "dry powder", at over 30% of AUM, private credit has completed its evolution from alternate lending into mainstream finance. This is most striking among small to medium enterprises (SME) and the middle-market space, where we are seeing a fundamental shift away from traditional banks to private credit managers as the main source of liquidity.

In last year's article, "Trends in the Expanding Global Private Credit Market: What to Expect for 2018 and Beyond", we gave an overview of the growth of the private credit market over the years and discussed some developing trends. In this article, we will briefly review the current global landscape for private credit and then look at some key issues for the industry going forward in 2019 and beyond.

Current Private Credit Landscape

The private credit landscape continued to grow, evolve and mature in 2018. Where private credit was once seen as an alternative to bank lending, more appropriate for smaller deals or riskier credits that traditional lenders forego, it is now a globally established source of mainstream finance. The private credit sector remains on track to reach $1 trillion AUM by 2020 as managers increasingly lend to a far wider variety of borrowers outside the middle market than ever before—from smaller businesses and start-ups to larger corporations and infrastructure projects. The private credit market now includes experienced asset managers with large, sophisticated investors lending to a broad array of small, mid-market and larger-cap borrowers.

Asset Managers

The United States of America and the United Kingdom remain key private credit hubs. A recent survey of nearly 70 participants in the private credit market representing an estimated $470 billion in private credit investments, conducted by the Alternative Credit Council (ACC) in collaboration with Dechert LLP (*Financing the Economy 2018: The role of private credit managers in supporting economic growth*, hereinafter the "ACC-Dechert Survey"), indicates that more than 60% of private credit managers are headquartered in the US and the UK.

The European continent is increasingly closing the gap on the US and the UK and is now home to nearly 20% of global private credit managers. ACC-Dechert Survey data reflects increasing interest in private credit in the European market, as Europe is home to more than twice as many firms that are new to private credit than are found in North America. Ten per cent of European respondents reported to the ACC-Dechert Survey that they have been managing private credit for less than two years, compared to only 4% of North American respondents. Germany, in particular, has been a key driver of growth for the region. ACC-Dechert Survey respondents indicated that German borrowers and sponsors have been increasingly embracing private credit.

The Asia-Pacific region is also a developing market for private credit. According to the ACC-Dechert Survey, approximately 15% of global private credit managers have their headquarters or primary asset-management centre in the Asia-Pacific region.

Investors

The investor landscape for private credit is increasingly diverse, with a wide range of investor types, both institutional and otherwise, committing capital to private credit. According to the ACC-Dechert Survey, over 70% of all private-credit committed capital comes from institutional investors such as pension funds, insurers and sovereign wealth funds. These investors may have initially been drawn to private credit in the years following the global financial crisis as government and investment-grade corporate bond yields collapsed. What began as a cyclical trend has become a structural shift: an increasing number of institutional investors now have specific alternative-credit allocation categories in their portfolios.

Private credit is not strictly the domain of institutional investors. The sector remains open to smaller investors such as family offices, who account for about 5% of capital committed to private credit, according to the ACC-Dechert Survey. Family offices are typically seen as more flexible and, along with high-net-worth individuals, tend to have greater risk appetites than their institutional peers. Smaller investors also tend to make smaller commitments and therefore do not face the institutional-investor challenges of finding funds large enough to accept them and having to abide by internal policies preventing them from representing over a certain percentage of a manager's AUM.

The investor base for private credit is even more geographically diverse than that of the sector's asset managers. Data from the

ACC-Dechert Survey shows that slightly under a third of private credit investors are based in the US (32%), followed closely by the percentage of investors based in Europe outside the UK (31%). Another 14% of investors are based in the Asia-Pacific region. The disparity between the geographic bases for private credit investors and asset managers is largely due to the openness of US funds to seek global investors. Whereas European funds tend to do the bulk of their capital raise onshore, US-based funds frequently use non-US structures or a parallel vehicle to the principal fund to source committed capital.

Another area of distinction between North American and European private credit funds is the extent of participation by insurers as investors. Insurers account for 38% of capital committed to European private credit funds, according to the ACC-Dechert Survey—twice the percentage that insurers allocate to North American funds. These figures evidence that European insurers are increasingly making private credit a major component of their fixed-income investment portfolios.

Although investors are increasingly familiar with private credit and how to integrate private credit investments into their overall investment portfolio, the ACC-Dechert Survey found that a significant number of investors are committing capital to the private credit sector for the first time. Survey respondents indicated that, on average, 25% of investors are first-time allocators to private credit. This indicates that opportunities remain available to investors who find the wide variety of risk and maturity profiles available with private credit attractive.

Structures

The private credit industry continues to innovate on fund structures and terms, but has settled on a closed-ended commitment and drawdown structure as the most popular fund model to suit long-term lending. Approximately two thirds of the managers responding to the ACC-Dechert Survey use closed-ended structures, operating as limited partnerships or business development companies (BDCs). By using these structures, private credit managers provide a stable source of long-term capital for borrowers that also mitigates against pro-cyclical tendencies in the credit markets.

The Cayman Islands and Luxembourg continue to be the most popular fund domiciles, while US-domiciled fund structures have become less popular over the last 12 months. North American managers have a much stronger preference for Cayman Islands-established funds than European managers, with over half of North American private credit funds domiciled in the Cayman Islands, according to the ACC-Dechert Survey. European managers favour Luxembourg for the majority of their private credit funds, with the remainder divided mostly among the Cayman Islands, Jersey and Ireland. These figures support the observation discussed above of an onshore geographic focus for European-fund capital raises: European managers are more likely to raise capital close to home, where a combination of tax, legal and regulatory factors makes an onshore structure more attractive to most allocators.

Smaller and larger private credit managers tend to favour Cayman Islands structures in equal measure, but larger managers have been far more open to domiciling funds in Luxembourg and Ireland. The explanation for the discrepancy may be based on two factors: Luxembourg and Ireland tend to require greater overall operational and regulatory attention and, therefore, expense, and are typically demanded by larger investors, which in turn will drive fund size.

Deal Focus

SMEs and middle-market borrowers continue to make up the core of private credit lending globally, but private credit managers are increasingly providing financing to both smaller and larger borrowers. The ACC-Dechert Survey reported that the average EBITDA of borrowers in the 2018 survey was $44 million, up from $38 million in the 2017 survey. With the increase in the average borrower size came an increasing dispersion of borrowers' EBITDA as well. In 2017, 39% of private credit managers reported an average borrower EBITDA of between $25 million and $75 million; in 2018 only 32% of respondents reported an average borrower size inside this range. Instead, private credit managers are increasingly lending to smaller companies: those with less than $25 million EBITDA accounted for 41% of overall borrowing activity, while larger companies, with over $100 million EBITDA, accounted for 17%.

While the total volume of capital allocated to private credit strategies has increased, the distribution of capital across different subsets of the private credit market has remained broadly consistent. Most of the asset allocation of private credit managers remains with leveraged lending, but many funds are diversifying (and some are specialising) in infrastructure, real estate, trade, asset-backed, distressed and other transactions.

Private credit investors continue to show a preference for higher positions in the capital structure, with more than 40% of capital allocated to senior secured debt strategies, according to the ACC-Dechert survey. This preference likely stems from the many investors still placing greater value on a loan's security than on its potential to make an outsized return; the stage of the credit cycle in which the economy finds itself is likely also a significant factor. Although senior secured financing is the most prevalent structure in private credit, financings are also frequently structured as unitranche, second lien and other junior financing investments.

The structure, terms, syndication and overall documentation of private credit transactions is indistinguishable from that used for similar mainstream banking deals. The documents usually contain all the provisions to support a wide bank syndication regardless of whether the loan is intended to be closely held or not.

Themes and Trends Going Forward

As the private credit market expands and matures globally, we see certain trends and themes developing that will shape the market going forward in 2019 and beyond.

Increased Credit Analysis, Diligence and Process

The end of 2018 saw a prevailing sentiment emerge among investors that weakening economic conditions, fallout from the ongoing trade war, stock market volatility and uncertainty over the length and frequency of government shutdowns have spelled the end of a long credit-cycle boom. It remains to be seen whether the Federal Reserve's recent shift in rate policy will allay investors' fears that a combination of these factors and rising interest rates means that workouts of a material portion of funded private debt are inevitable.

What is clear from the data on borrower fees, interest rates and financial covenants is that, for the time being, private credit remains a borrower's market. Almost four times as many respondents in the ACC-Dechert Survey reported that arrangement fees are decreasing rather than increasing, while twice as many respondents reported a weakening of financial-covenant protection than did a strengthening.

Financial-covenant headroom of 25% or more was typical for more than half of their deals. The ACC-Dechert Survey picture on loan coupons was more nuanced, with a plurality of respondents reporting higher rates over the last year. However, a third of respondents reported that coupons had lowered over the last year and over 20% reported no change.

Factors driving these borrower-friendly terms include increased deal competition and developing deal terms in upper-market deals trickling down to the middle market. Though it started as a more bespoke approach to lending, private credit lending in the middle market is increasingly becoming precedent-driven, which is further advancing the general relaxing of covenants and defaults. At the same time, private credit managers highlight that the ability to identify and analyse viable credit opportunities is a differentiator that can allow them to relax certain deal terms without sacrificing overall robustness in lending practices.

In that vein, private credit managers have been responding both to general concerns about the future economy and the loosening of deal terms with an increased emphasis on credit analysis and diligence. Covenants have never been a substitute for market research and credit analysis, though stricter covenants have always allowed more wiggle room for setting the model correctly. With that wiggle room shrinking, private credit managers that have robust market-research-and-analysis and credit-risk-assessment teams will likely have a performance advantage over those who do not.

Another advantage will come to those managers who are building teams with knowledge of default scenarios and restructuring. The ability to navigate workout scenarios is becoming an increasingly relevant consideration for managers and one they use to differentiate themselves from their competitors. The private credit industry was launched on the heels of the financial crisis and ensuing recession, but has never been through a systemic downturn of its own. Now that private credit funds account for the majority of middle-market deal volume, an increase in defaults and adverse changes in economic conditions will squarely affect the industry. The development of workout expertise will help cushion those blows.

Another reason for encouragement in the event of an economic downturn is the abundance of dry powder available to private credit funds to provide liquidity to be flexible in responding to workout situations. Respondents to the ACC-Dechert Survey report dry powder levels on average as a third of AUM.

With that much available liquidity, there is little reason to fear that doom and gloom will arrive quickly. But there is also no reason for good money to follow bad, so increasing credit controls and bolstering workout and restructuring expertise internally or with outside advisors is a prudent strategy for private credit managers generally.

Building workout expertise is also key to fund raising going forward, as having strong and clear credit controls together with a team that can deal with distressed situations will help mitigate concerns of investors who keep hearing that the music will have to stop eventually.

Fund Credit Facilities

Funds are increasingly using credit facilities for leverage to provide liquidity between capital calls and returns and increase investing power through an additional source of funds.

The use of leverage may be subject to regulation depending on the nature of a fund, including the Investment Company Act of 1940 in the case of investment companies. To take a recent example, the Small Business Credit Availability Act (SBCAA), signed into law in March 2018, loosened the 1940 Act leverage rules applicable to BDCs by reducing the mandatory asset-coverage ratio from 200% to 150%, thereby allowing BDCs to hold only $1.50 in total assets instead of $2.00 for every dollar borrowed (for more information on the SBCAA changes, see *Small Business Credit Availability Act: Increasing Capital and Flexibility for Business Development Companies*, Dechert OnPoint, March 23, 2018). However, most fund managers using this strategy are conservative with leverage, with close to three quarters of those using the strategy keeping debt to equity at 2× or less. Anchor investors can also seek to limit fund leverage through the fund documents or side arrangements.

The use of leverage differs somewhat across asset classes. According to the ACC-Dechert survey, a majority of private credit managers focused on large corporates and SME/middle-market borrowers use leverage. By contrast, less than 40% of managers focused on distressed investing use leverage, and less than a third of managers who pursue real estate deals do so.

The use of leverage by private credit managers also differs across geographies: 58% of North American respondents to the ACC-Dechert Survey reported using leverage, compared to 40% of European fund managers. We expect the use of leverage to rise in Europe as comfort levels toward leverage continue to change. Overall, in 2018 the US continued to be the leading market for fund credit transactions, followed by the UK, Europe and Asia. So far, commercial banks lead in this space in all markets.

The two main types of fund-level credit facilities are credit lines based primarily on (a) the capital commitments by investors to the fund (Subscription Lines), and (b) the net asset value (NAV) of portfolio investments of the fund (NAV Facilities). A combination of both Subscription Lines and NAV Facilities, known as Hybrid Facilities, is also becoming increasingly utilised by private credit managers.

In the US market, fund finance tends to be collateral- and borrowing-base focused, with supporting covenants. Outside of the US, due to differing legal regimes governing the granting of, and enforcement on, collateral, fund-finance documents began as a more relationship- and covenant-based product. Over the last several years, the markets have been developing and converging more toward the US approach. This convergence is driven by several factors, including the increasing use of fund credit in all markets, the weight of US precedent, competition among lenders and the ongoing adaptation of core fund-finance documents to anticipate and accommodate credit structures. While collateral and regulatory regimes will necessitate essential differences across markets, we expect the overall convergence of core approach to continue.

Some key features of core fund-credit structures are described below.

Subscription Lines

Subscription Lines are usually utilised by the primary fund in a structure, i.e., the entity that holds the capital commitments from investors, but can also be used in more complex structures by lower funds, using commitments from feeder funds up the chain to support the credit. The purpose of Subscription Lines is to provide flexibility in responding rapidly to investment opportunities by providing quicker access to capital without the delay – or necessity – of capital calls.

Subscription Lines are usually short-term revolving facilities grounded in a borrowing base that is keyed off the quality of the credit and commitment of the investors to the fund. Advance rates, concentration limits and diversity criteria are all calculated on the basis of the investor pool and the credit of individual investors.

The collateral for Subscription Lines consists of the unfunded commitments of investors, including the right to make capital calls (allowing the lenders to "step into the shoes" of the fund and call capital if needed) and rights to the bank accounts that investors fund into. The Subscription Line does not have any claim to the assets or portfolio of the fund itself, just the unfunded capital committed to the fund.

It is not unusual for sophisticated fund investors to require that the amount of their funded capital commitment not exceed a set percentage of all funded capital at any time, with the net effect that such an investor does not fully fund ahead of the other capital commitments. These arrangements, usually documented through side letters to the fund documents, must be taken into account by lenders when setting the criteria for Subscription Line draws.

NAV Facilities

NAV Facilities are credits based primarily on the credit value of the fund's portfolio assets. They can be placed at the primary fund or at special purpose vehicle subsidiaries of the fund, and can be revolving or term debt, or structured as true sale or repurchase transactions.

The most common simplified NAV structure is to set up a special purpose vehicle (SPV) borrower to own an SPV subsidiary that holds the fund's portfolio. The lenders are then secured by a pledge of the portfolio assets as well as the equity of the SPV borrower and subsidiary. Given that funds often have many layers and multiple financings, the NAV structure also will be more complex and require the exclusion of assets and SPVs that are being utilised for other fund-finance transactions.

Private credit mangers use NAV Facilities to provide increased liquidity for investments and for growing their portfolio, which in turn provides a larger base for additional leverage. NAV Facilities are also used to provide better returns for investors to the extent that the funds borrow at lower rates than they receive on direct lending and other portfolio investments.

The credit analysis for NAV Facilities is based on the quality of the fund's portfolio investments, with the borrowing base (or purchase terms) based on different advance or purchase rates that depend on the nature of the fund's underlying investments (e.g., senior, secured, subordinated, etc.). Consequently, the value of the portfolio is continually updated (usually weekly or monthly) and lenders typically have triggers to require third-party valuation updates. Most NAV Facilities are geared off of portfolio debt investments, but there are transactions in which equity investments, including equity of portfolio owned companies, are included.

The assets supporting the NAV Facility consist of the pledge or purchase of the portfolio investments of the fund, as well as a control agreement and pledge over the accounts that receive the proceeds of the investments, and brokerage or custody accounts that hold the investments. While a pledge of all fund assets forms the collateral base, it is common for portfolio investments to have restrictions and/or third-party conditions on pledges and assignments, which can exclude them from the collateral. Accordingly, lenders will also take a pledge of equity from the entities within the fund constituting their credit group to better capture the value of the portfolio. NAV Facilities, by contrast with Subscription Lines, do not have recourse to the capital commitments of the investors in the fund.

Covenants are critical to NAV Facilities and usually include maintenance of a minimum tangible net worth or loan to value or asset coverage ratios and mandatory prepayments (or additional portfolio support) in the event of changes in valuation.

Hybrid Facilities

Hybrid Facilities combine the features of both Subscription Lines and NAV Facilities into one credit facility.

By combining the collateral and borrowing-base features of Subscription Lines and NAV Facilities, Hybrid Facilities are more economically efficient than co-existing side-by-side facilities and provide more flexibility for access to liquidity throughout the lifecycle of the fund.

Further, by blending collateral and borrowing bases, the Hybrid Facility can be tailored to the needs of individual funds and provide both pricing breaks for the borrower based on changes in concentration of the asset mix in the borrowing base as well as increased sources of repayment for the lender.

Given the overall cost savings and efficiencies of Hybrid Facilities, we expect the use of Hybrids by private credit managers to rise going forward.

Conclusion

While the drumbeat of a potential economic downturn bangs louder, the position of private credit managers as the dominant source of financing for SMEs and middle-market companies and as an increasingly viable alternative to traditional bank-led financings in other markets has become entrenched.

With increased experience and sophistication in the private credit industry has come increasing exposure to leverage, though typically modest in size and aligned with the maturity of the underlying assets. Managers using leverage are boosting their returns and demonstrating the flexibility and quick access to liquidity that has fuelled the growth of the industry. Those who are also increasing their workout expertise and maintaining a supply of dry powder during this period of growth will be particularly well placed for any downturn.

The private credit industry at this stage is a fully matured alternative to traditional bank lending and a permanent and key component of the financing markets and global economy. We expect this to continue and believe private credit funds are positioning to handle a downturn in markets.

For further reading: Financing the Economy 2018, the role of private credit managers in supporting economic growth, Dechert/ Alternative Credit Council (2018).

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Chapter 20

Investment Grade Acquisition Financing Commitments

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The investment grade loan market was especially busy in 2018, reaching a record $1 trillion, an increase of 26% over 2017. Although the leveraged loan market stalled in the fourth quarter of 2018, investment grade loans totalled $296 billion. Within the investment grade space, there were $235 billion of merger and acquisition financings in 2018, up from $203 billion in 2017.[1] Examples of transactions announced in 2018 with an investment grade bridge loan commitment include: T-Mobile USA/Sprint Corporation ($27.0 billion); IBM/Red Hat ($20.0 billion); Constellation Brands/Canopy Growth (C$ 5 billion); and CenterPoint Energy/Vectren ($5 billion). And 2019 got off to a fast start, with an announced $33.5 billion bridge facility for Bristol-Myers Squibb's acquisition of Celgene. This article provides an overview of bridge loan commitments for investment grade companies in the U.S. bank market.

The investment grade bridge loan commitment is an important component of middle and large cap merger and acquisition transactions involving investment grade acquirors[2] (also referred to in this article as borrowers). The bridge loan commitment provides assurance to the acquiror and seller that the acquiror will be able to fund the cash portion of the purchase price at closing, whether or not the acquiror has suffered a material adverse change and whether or not the funds can be raised in the capital markets. Investment grade bridge commitments represent a commitment to lend a short-term bank loan (i.e., a loan that matures in 364 days) to fund the cash purchase price of an acquisition in the event long-term or "permanent" financing (i.e., a loan with a maturity of more than one year, with some exceptions) has not been raised as of the closing. This is typically provided by large banks in the U.S. because the committing party must have sufficient capital to hold these commitments through sometimes lengthy executory periods of merger and acquisitions transactions (although, as discussed below, the commitments are frequently syndicated after the execution of the commitment documents). Permanent debt financing is typically in the form of a combination of notes issued in the capital markets and bank term loans, with the proportion depending on market conditions; but in the majority of transactions, notes provide the majority of the financing. To the extent a financing package includes a mix of bridge loans and bank term loans (in *lieu* of or to refinance bridge loans), the bank term loan component adds flexibility to the borrower's capital structure since bank debt has more liberal prepayment provisions than notes issued in the capital markets. The balance of the funds required might be obtained from commercial paper, cash on the balance sheet of the borrower, and sometimes, the target company's cash on hand.

The terms of the bridge loan typically include a 364-day maturity, no prepayment penalty/call protection, and floating interest rates with margins based on a ratings-based grid. Unlike in a below investment grade leveraged buyout bridge commitment, there is no provision to convert the bridge into longer term debt after a year at the option of the lenders. Expenses including ticking fees, funding fees, duration fees and increasing interest rate terms make a funded bridge loan more expensive financing than is expected for the permanent financing. Instead of incurring the bridge loans, the borrower generally expects to fund the acquisition with the proceeds of permanent debt and sometimes, equity financing. Only if the borrower is unable to raise permanent financing to fund the acquisition (or is unable to do so on attractive terms) will it draw down the bridge loan commitment to close the transaction.

Advantages of Bridge Financing Commitments

Sellers to investment grade companies expect that the obligation of the buyer to close the acquisition will not have a financing contingency. In addition, the seller will want to know the general sources of the cash portion of the purchase price available to the borrower. The bridge loan commitment fills this gap, without requiring the borrower to have the cash on hand at the time of the signing of the acquisition agreement.

Additionally, while an investment grade company is generally able to access the capital markets on short notice on favourable pricing terms, in an acquisition there is often an extended period between signing and closing while regulatory and shareholder approvals are obtained. Raising the permanent financing immediately upon signing might lock the borrower into funding it may not eventually need, require an expensive escrow arrangement for notes with expensive call premiums, and/or require the borrower to incur bank term loans. In each such case, the closing of the financing would require the immediate payment of financing fees and the ongoing added interest expense during the executory period with no guarantee that the acquisition will close. Consequently, a bridge loan commitment allows the borrower to defer incurring the expense of raising permanent financing until it has better visibility on the likelihood of closing the acquisition.

Once the conditions to closing the acquisition are satisfied, the borrower will be obligated to close promptly. If at that time, the market for permanent financing is unavailable to the borrower, the borrower might not be able to raise the financing required on favourable terms, or at all. As a result, a bridge financing commitment reduces risk on both the borrower and the seller. It also makes a potential buyer's bid more competitive, since a competing bid would arguably also need a bridge financing commitment to be credible and the competitor might find that banks are unwilling or not able to issue large commitments to multiple bidders.

Documentation

The initial documentation for a bridge facility commitment will include a commitment letter, together with a term sheet setting forth the terms and conditions of the bridge loan. In addition, a fee letter documents the fee arrangements with the lead arrangers. Finally, an engagement letter for the notes component of the permanent financing to be issued in the capital markets (as opposed to term loans) is also typically part of the documentation package. These letters will be signed concurrently with the acquisition agreement.

The process of negotiating the bridge facility commitment may require substantial time, depending on how many lead arrangers compete for the assignment or the level of detail specified in the term sheet. The borrower may seek proposals from multiple banks and conduct parallel negotiations with each in an effort to identify competitive terms. Alternately, the borrower may elect to work initially with only one or two institutions in order to avoid bringing additional parties that could complicate the confidential acquisition process.

Even though the commitment letter and fee letter do not include many of the detailed provisions which are set forth in the credit agreement, these letters are meant to cover all key economic terms and are thus highly negotiated.

If the borrower has an existing credit facility prior to announcement of the acquisition, the credit agreement for such facility will be used by the parties as the documentation precedent for the bridge loan. Among other things, any financial maintenance covenants in the bridge facility will typically track the financial covenants in the borrower's existing credit facility. However, as is discussed below, the closing conditions in the bridge credit agreement will be more limited than in the borrower's existing bank credit facilities. In particular, the occurrence of most events of default (except as to bankruptcy or specified representations and warranties) are typically not a closing condition.

Conditions

The conditions precedent to funding the bridge facility are a key component of the commitment letter. In general, the conditions to funding the bridge loan are very limited, especially as compared to a bank commitment letter in certain other acquisition scenarios. Acquisition bridge loan commitments adhere to the principal of "limited conditionality", which provides for a narrow set of conditions, the satisfaction of which is largely in the borrower's control. In addition, the commitment letter typically limits the borrower's damages to direct damages if the lender fails to fund.[3]

For the lenders, the basic conditionality requirements are twofold. First, if the seller fails to satisfy the conditions to closing in the acquisition agreement, the lenders are not required to fund (acquisition-related conditions). Second, the borrower must comply with basic documentary formalities, and provide its historical financial statements (and depending on the significance of the transaction, those of the target) in order to facilitate placing the permanent financing (information-related conditions). Specific components of these conditions are further summarised as follows.

Information-related conditions

Depending on the significance of the acquisition, financial statements of the acquired company and *pro forma* financial statements might be required by the SEC to market the permanent financing in a public offering. Consequently, the borrower may need to require delivery of additional financial information from the seller beyond what the target company has historically prepared in order to satisfy the bridge financing conditions. This is most likely to become an issue for negotiation if the target company does not already have audited financial statements, which could occur if the target company is a division of another company. It is also customary for the acquisition agreement to contain a covenant in which the target company agrees to cooperate with the borrower's financing process.

However, it is not customary in an investment grade bridge financing commitment to have, as a condition to funding the bridge, a specific minimum "marketing period" for the marketing of a notes offering, during which the requisite financial information was available. Such marketing periods are typically seen in below investment grade bridge loan commitments.

Acquisition-related conditions

Certain conditions to the bridge financing have the effect of ensuring that the acquisition proceeds in a manner not materially different from what was agreed by the borrower and the seller at the time of the bridge financing commitment.

Prior to making the bridge facility commitment, the lead arrangers are afforded the opportunity to review the acquisition agreement, as well as conduct due diligence on the seller and the target company. As a result, the scope of the representations and covenants in the acquisition agreement will have been satisfactory to the lead arrangers at the time of signing. The bridge facility will then include certain conditions directly tied to the acquisition agreement.

First, a condition that the acquisition agreement will not have been amended, modified or waived after the signing date in a manner that would be materially adverse to the lenders is customary. Second, lenders typically require that there be a condition that no "Target Material Adverse Effect" (as such term is defined in the acquisition agreement) occurred during the period between the signing of the commitment and closing.[4] Third, the lenders' obligation to fund the bridge loans is conditioned upon the representations and warranties of the target company in the acquisition agreement being true and correct in all material respects at closing, to the extent that such representations and warranties are material to the interests of the lenders and breach of such representations and warranties would give the borrower the right to terminate the acquisition agreement.

In each case, the acquisition-related conditions in the bridge facility commitment letter should track the corresponding conditions in the acquisition agreement. The conformity of the conditions is important to the buyer (and the seller) so that, once the conditions to the acquisition are satisfied and the parties are in a position to close the acquisition, the conditions to the bridge loan financing are concurrently satisfied, which allow certainty of funds.

Other conditions

In addition to the description above, the conditions to funding the bridge will include (i) the accuracy in all material respects of certain fundamental or "specified" representations as to the borrower under the bridge loan credit agreement, (ii) the delivery of customary certificates and legal opinions, (iii) the delivery of "know your customer" information required by law with respect to the borrower, (iv) payment of fees and expenses, and (v) absence of bankruptcy defaults as to the borrower.

Syndication

The initial bridge loan commitment is often provided by only one or two lenders acting as lead arrangers, who then seek to syndicate a substantial portion of their commitments to a group of financial institutions. The syndication process is planned in advance by the lead arrangers and the borrower with pre-identified potential syndicate lenders, who are often (but are not required to be) the borrower's existing relationship banks.

As part of the syndication process, the lead arrangers and the borrower will host a conference call or bank meeting to launch the marketing and provide information (on a confidential basis) to the potential syndicate lenders regarding the acquisition and the terms and conditions of the bridge financing. The syndicate lenders will then commit to their respective allocations of the bridge facility, either through a joinder agreement to the commitment letter or by entering into a bridge loan credit agreement with the borrower and the lead arrangers. Upon entering into such joinder agreement or credit agreement, the syndicate lenders will generally be contractually committed to fund the bridge in their respective syndication amounts, and the lead arrangers will thereafter only retain a contractual commitment to fund in respect of the non-syndicated amount.

Concurrent with their commitments under the bridge facility, the syndicate lenders will be engaged for a proportionate role in the permanent debt or equity financing to fund the acquisition. Part of the reason the syndicate lenders (like the lead arrangers) are willing to commit capital to back the bridge loan commitment, is that in addition to sharing in the bridge fees, they are afforded the opportunity to earn fees associated with the future debt or equity offerings of the borrower in *lieu* of or to refinance borrowings under the bridge facility.

If the lead arrangers are unable to complete the intended syndication with the pre-identified group of lenders, they may expand the syndicate to additional institutions subject to certain limitations. Any additional institutions will at least be subject to consultation with the borrower (and will typically require the borrower's reasonable consent), and the commitment letter may specify that all syndicate lenders be institutions with investment grade credit ratings.

If the intended syndication is not achievable because banks are unwilling to take on a portion of the commitments on the agreed terms, the lead arrangers may exercise their "flex" rights to make the terms of the bridge facility more favourable to the lenders. The "flex" for an investment grade bridge facility will typically be limited to an ability to increase pricing by up to a certain negotiated amount, but can include other changes to the terms of the bridge facility.

Prior to funding of the bridge, any assignment by the syndicate lenders of their commitments will be subject to consultation with the borrower, or its consent. In many financings, borrower consent is not required for assignments to existing syndicate lenders or their affiliates. In addition, the borrower may be able to designate "disqualified" institutions, consisting of competitors of the borrower and other institutions identified by the borrower prior to a specified date (which can be either the initial commitment date or the closing date), which may not become lenders without the borrower's consent in its sole discretion, either before or after funding of the bridge. Disqualified institutions may also include affiliates of competitors that are reasonably identified by name or that are known in the market as affiliates of competitors.

In order to avoid interference with the syndication, the commitment letter will typically include a "clear market" provision. The clear market prohibits competing financings, with exceptions for the anticipated permanent financings, refinancings of existing debt and other ordinary course financings. Other exceptions to the clear market provision are often requested by borrowers to address specific situations or needs of the borrower and are often highly negotiated. Another consideration in negotiating the "clear market" is whether it will apply only to the buyer or to the target business as well (and whether the seller will agree in the acquisition agreement to comply). To facilitate syndication, the commitment letter will contain a covenant in which the borrower agrees to cooperate with the arrangers, and to use commercially reasonable efforts to cause the seller to also cooperate. However, compliance by the borrower with the cooperation covenant would usually not be included as a condition to the lenders' obligation to fund the bridge loans.

Commitment Reductions and Permanent Financing

During the period between signing and closing of the acquisition, the lenders will require that the proceeds of any significant capital raise not required for a specified purpose be applied to pay the acquisition consideration. As such, the lenders will ask to include in the commitment letter that the bridge facility commitment be reduced on a dollar-for-dollar basis with the net proceeds of debt and equity issuances and non-ordinary course asset sales, subject to certain negotiated exceptions.

The permanent financing to reduce the bridge facility may comprise the proceeds of debt, in the form of bonds or term loans, and/or the proceeds of an equity offering. The composition of the permanent financing will be based on factors including market conditions, desire to maintain a certain credit rating and other capital structure considerations.

Exceptions to the commitment reduction requirement are intended to anticipate other capital needs of the borrower during the period between signing and closing of the acquisition. For example, if there is a need to raise funds to refinance existing debt during the commitment period but prior to closing, or to make a separate investment or acquisition that may take place during such period, then such amounts should be excluded from the mandatory commitment reduction requirement (similar to the exclusion from the "clear market" covenant). One point that is often negotiated is whether this exception to raise money to refinance existing debt should apply only to debt maturing during the commitment period or also debt maturing within a limited time period after the commitment period terminates (i.e., through one year after the termination date of the commitments). In addition, amounts borrowed under existing credit lines will typically not be required to reduce the bridge. Furthermore, it is customary to set a "*de minimis*" threshold, below which proceeds of debt and asset sales will not be required to reduce the bridge facility commitment. A "*de minimis*" threshold for equity proceeds is less common.

Fees and Pricing

The economics for lenders in a bridge facility commitment include several types of payments which are scheduled to be made at different times during the period of the commitment.

First, the lead arrangers and any other lender that provides a commitment may be paid a commitment fee for their initial commitments at signing of the acquisition agreement. The amount of this fee is not publicly disclosed.

Second, the lenders will be compensated for maintaining the commitment for an extended period of time by a "ticking fee", the terms of which are generally set forth in the term sheet. There may also be a second commitment fee paid on the outstanding amount of the bridge loan commitments as of a specified date after signing, also related to the commitment being maintained for an extended period. These fees will be paid on a *pro rata* basis to all lenders in the syndicate at such time. The dates on which the ticking fee commences and any additional commitment fee is paid are points for negotiation, and may vary across deals based on transaction-specific circumstances and market conditions.

Third, the lenders will be compensated for funding the bridge loan commitment paid as a one-time funding fee payable on a *pro rata* basis to the bridge lenders. In addition, the lenders might be entitled to a "duration fee" at 90, 180 and 270 days after funding. The most typical structure of the duration fee is 0.50% after 90 days, 0.75% after 180 days and 1.00% after 270 days. The purpose of the "duration fee" is to encourage the borrower to refinance a funded bridge loan with permanent financing as expeditiously as possible after the closing date.

Fourth, the initial interest rate margins on the bridge facility will increase following funding of the bridge. The most typical rate of increase for interest rate margins is 0.25% on each of the 90th, 180th and 270th days after funding.

To address potential changes in the business prospects of the borrower between signing and closing (and after funding), the interest rate margins for the bridge loan will typically be based on a ratings-based grid. Pricing will therefore adjust higher or lower in order to reflect the credit ratings of the borrower at any given time. The ticking fee rate may also be ratings-based, though a flat ticking fee is not unusual.

In addition to the fees set forth above, all of which are directly connected to the bridge loan commitment and the bridge facility, the lead arrangers and the other lenders will also earn customary negotiated fees in connection with debt and equity offerings for the permanent financing.

The commitment letter, fee letter and/or engagement letter, as the case may be, will usually provide that the committing lenders are entitled to some or all of the fees payable in connection with the bridge loan commitment or the permanent financing, if the borrower pursues an alternate transaction in which other lenders are engaged to provide financing for the acquisition. The specific terms of what type of transaction and/or alternate financing would require payment of the alternate transaction fee, as well as which fees and what percentage of those fees would be payable, are highly negotiated and may differ from deal to deal.

Market Trends

Documentation. The documentation for investment grade bridge facilities has tended to become less burdensome. Traditional market practice had been for the borrower to enter into a credit agreement with the lenders upon completion of syndication, with the credit agreement superseding the commitment letter provided at signing. Increasingly, syndication of the bridge loan commitments is documented through the commitment letter, rather than a credit agreement. In such cases, the parties will negotiate a bridge loan credit agreement only in the event that funding of the bridge facility appears likely to occur. By foregoing a credit agreement at the outset, the borrower is able to avoid a costly and potentially time-consuming negotiation process for an agreement that the parties do not expect to be needed for funding.

Non-bank lenders. We continue not seeing a trend of non-bank lenders taking lead arranger roles in the investment grade bridge market. This is in contrast to the below investment grade market where non-bank credit fund managers are moving up the league tables with larger market shares.

Conclusion

Bridge financing commitments in very large sums remain available to better-rated investment grade companies despite a more uncertain global economic outlook and market volatility at the end of 2018 which is being closely watched by lenders and borrowers.

Endnotes

1. See *Record-Setting 2018 U.S. Loan Issuance tops US$2.6 trillion*, Gold Sheets, January 7, 2019, P. 1, 23–25 (Thomson Reuters).
2. Investment grade companies are those that have "investment grade" credit ratings from the major rating agencies. This means, in the case of Standard & Poor's, a rating of BBB- or better, and in the case of Moody's, a rating of Baa3 or better.
3. Language in a revolving credit agreement precluding "special, punitive, indirect or consequential damages" was recently upheld by the US district court for the Southern District of New York when lender refused to fund (see *Weisfelner v. Blavatnik (In re Lyondell Chem. Co.)*, 585 B.R. 41 (S.D.N.Y. 2018)).
4. Note that 2018 saw the first ruling by the Delaware Court of Chancery permitting the buyer to terminate a merger due to a material adverse effect (see *Akorn, Inc. v. Fresenius Kabi AG, C.A.* No. 2018-0300-JTL, 2018 Del. Ch. LEXIS 325 (Del. Ch. Oct. 21, 2018), affirmed by *Akorn, Inc. v. Fresenius Kabi AG*, No. 535, 2018, 2018 Del. LEXIS 548 (Del. Sup. Ct. Dec. 7, 2018)).

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Acquisition Finance in Latin America: Navigating Diverse Legal Complexities in the Region

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Private equity and strategic investors continue to demand loans with "certain funds" or "SunGard" limited conditionality to finance their M&A activity in Latin America. Having survived many geopolitical challenges in 2018, the M&A market in Latin America should improve in 2019 from greater political stability, accompanied by other local trends that suggest increased opportunities for investors and lenders financing M&A activity in the region.

For any acquisition finance transaction in Latin America, the parties will need to consider country-specific concerns, including guaranty limitations and security steps and timing, applicable withholding tax regimes and exchange control regulations, to determine the optimal structure and lender syndicate composition for such transaction.[1]

M&A in Latin America

Latin American M&A in 2018 included 600 announced deals for a total of US$72.6 billion of value, which was a decrease in value of 25.3% in comparison to 2017 and the lowest total deal value on record since 2005.[2] In Latin America, 2018 was plagued by domestic and cross-border political and economic uncertainty, including seven presidential elections (in Brazil, Colombia, Costa Rica, El Salvador, Mexico, Paraguay and Venezuela) and two transitions to power (in Chile and Cuba), trade wars and corruption scandals, among other challenges. Despite the unstable geopolitical environment, the total number of Latin American M&A deals in 2018 was only 54 below the 2017 level (600 in 2018 as compared to 654 in 2017).[3] Also, there were bright spots as 2018 set a number of records for Latin American M&A activity. The industrials and chemicals sector set a new record, closing the year with US$23 billion worth of deals, which was nearly 2.5 times the value registered by this sector in 2017 (in part due to a single US$15.3 billion acquisition of Fibria Celulose in Brazil). The deals in 2018 also included the second-highest total deal value on record in the technology sector with US$2.4 billion (double 2017's US$1.2 billion) and record deal counts in the construction sector (with 30 transactions worth US$2.3 billion) and in the pharmaceuticals, medical and biotech sector (with 69 transactions worth US$1.8 billion).[4]

For 2019, the International Monetary Fund is forecasting that the GDP in Latin America and the Caribbean will grow by 2.2%, with country-specific variations (Argentina: a decrease of 1.6%; Brazil: an increase of 2.4%; Chile: an increase of 3.4%; Colombia: an increase of 3.6%; Mexico: an increase of 2.5%; and Peru: an increase of 4.1%).[5] The Intralinks Deal Flow Predictor report predicts that through Q1 2019, Argentina is expected to show the highest increase in M&A announcements among the largest Latin American economies, whereas levels of M&A announcements are expected to be flat to declining in Brazil, Chile, Colombia, Mexico and Peru.

Opportunities for International Lender Activity in Latin America

Despite certain warning signs of market stress, the following country-specific factors should continue to provide opportunities for international lenders in financing M&A activity in Latin America.

- In Argentina, the federal government's launch of a huge infrastructure plan through public-private partnership structures coupled with the lift of the legal and *de facto* foreign exchange restrictions applicable to cross-border financings seem poised to increase M&A in the country and the opportunities for off-shore lenders to finance that activity. However, recent devaluation of the Argentine peso and high inflation may hinder such increase.
- In Brazil, although financing for acquisitions has traditionally been provided by local banks and local debentures with much support also being provided at below market levels by the National Development Bank ("BNDES"), BNDES' recent retreat from activity may create additional opportunities for off-shore banks. In this regard, BNDES has been gradually changing its credit portfolio over the past few years from a concentrated portfolio formed by large corporations (known as "Super Nationals") to a more diverse base, including venture capital and seed funds focused on start-ups and small-sized companies. In the near future, also, BNDESPar, the equity investment vehicle of BNDES, will play an important role in M&A activity in Brazil, either by divesting major equity stakes in large corporations or by investing in such small-sized companies mentioned above.[6] Brazilian corporates with US-dollar revenues, including, in particular, exporters of commodities, are the most likely borrowers of US-dollar off-shore debt, given that currency hedging costs may be prohibitive, but market participants continue to explore structures to minimise currency risk for Brazilian borrowers without significant US-dollar revenues. Some interesting transactions took place in 2018, despite the political turbulences throughout the year. For instance, the IPOs of PagSeguro and Stone, major credit card processors in Brazil, were very well received by the market.[7] With the new Federal government having taken office on January 1, 2019, market players expect increased activity in terms of project finance for infrastructure, privatisation and equity deals in general.
- In Chile, on the heels of the election of centre-right President Sebastián Piñera in December 2017 there were mixed results for M&A activity in 2018, which closed 2018 with 56 transactions (a decline from 57 transactions in 2017) with a value of US$12.4 billion (half of the US$24.6 billion recorded in 2017).[8] In 2018, there were several landmark transactions, such as Scotiabank (Bank of Nova Scotia in Chile) acquiring the BBVA operations and Chinesse Tianqui entering into

the non-metallic producer SQM. Copper prices and public policies ensure that there will be an additional increase in mining, infrastructure and energy transactions.

- In Colombia, given the huge wave of road concessions together with a high sponsor concentration, it is expected that international investors will continue purchasing stakes in these projects, which may require acquisition financing, depending on the stage of development of the relevant project. Additionally, multi-latinas will continue to expand from and into Colombia and into the countries of the Pacific Alliance (Chile, Peru and Mexico), which acquisitions typically rely on financings from both the international and the local banking markets.
- In Mexico, although the uncertainties created by the possibility of Mexico not reaching a trade agreement with the U.S. and Canada have ended with the signing of the new United States-Mexico-Canada Agreement (USMCA), the arrival of a new administration to the federal government with control of both chambers of congress may generate uncertainties but also opportunities for M&A activity. It is expected that during the first months of the new administration investors will take an opportunistic stand and consider in their investment decisions the policies and direction that the new administration adopts in different sectors that have driven M&A activity in Mexico in recent years (i.e. financial, infrastructure, power, oil & gas and real estate development).
- In Peru, financing for acquisitions by foreign investors has traditionally been provided by off-shore lenders or affiliated companies. Local investors traditionally have preferred loans from local banks, including bridge loan to bond take-out structures. Recently, local investors with Peruvian bank relationships with access to medium- and long-term acquisition finance structures through local banks and local investment funds, including mezzanine funds, are providing some acquisition financing to local investors. There have been discussions in political circles recently about eliminating the 18% VAT applicable to interest payments to foreign lenders that are not financial institutions, which would facilitate loans by such off-shore lenders to Peruvian investors, but the legislative change has not yet passed.

Latin American Acquisition Finance Transactions

Pure leveraged, limited-recourse acquisition loan finance transactions occur in Latin America less frequently than in the US or Europe. This is partly because the volumes of M&A activity in the region (US$72.6 billion in 2018) are still a fraction of US M&A activity (US$1.5 trillion in 2018) and European M&A activity (US$989.2 billion in 2018).[9] Country and currency risks specific to the region also add to lenders' perceived risks of such limited-recourse loans. In addition, non-financial institution lenders, which are traditionally the lenders interested in providing term loan Bs, a preferred source of debt financing by private equity funds, have been relatively inactive in the region due to unfavourable local withholding taxes, which are often applicable in the region to off-shore lenders that are not financial institutions or are organised in countries designated as tax havens. And local banks have often been able to provide competitive pricing in this environment.

In our experience, international lenders have been more active in providing acquisition finance bridge loans in Latin America, which often take the form of bridge-bond take-out structures, and are frequently tied to M&A advisory mandates or other larger client relationships. Also, we have seen that Asian and European banks that are active in the medium- and long-term project finance markets have been active in leveraged acquisition financing – with project finance-style debt-sizing parameters – of single-asset or portfolio power or infrastructure deals supported by US-dollar linked, long-term commercial contracts. At the same time, we have often observed, in line with the business drivers of the international banks, acquisition finance in the region being backed in whole or in part by corporate balance sheets, with customised, non-all-assets collateral packages when leverage exceeds 3.5 to 4.5 times EBITDA.

As private equity funds and strategic buyers seek loan financing for their targets in Latin America, cross-border acquisition loans will remain an important, if not critical, part of the capital toolbox. A buyer will generally require certainty of loan funds before committing to a purchase agreement, whether the acquisition loan financing takes the form of a bridge loan or longer-term financing, whether the target is a corporate or project, and whether the buyer is a strategic corporate or a private equity fund. The volumes of M&A activity in the region, including in the real estate, energy, natural resources and infrastructure sectors in particular, would appear to be a promising source of highly bankable senior acquisition loans, with or without capital market take-outs.

Loans vs. Bonds

Loans tend to take centre stage in acquisition finance transactions because a loan commitment provides the needed certainty that debt funds will be available at closing. Typically, a purchase agreement for an acquisition will not include a "financing-out", i.e., a right to terminate the purchase agreement if the buyer cannot finance the transaction, and before signing the purchase agreement the buyer will need certainty that the required debt will be available at closing. Although an acquisition finance transaction may take the form of loans or bonds, it can be a challenge for a buyer to rely on a planned bond issuance to close an acquisition, given the notorious volatility of the capital markets. Buyers tend to rely on loan commitments from banks and other lenders to finance acquisitions, either in the form of term loans or bridge loans, which may be refinanced post-closing with a capital markets bond issuance.

Loan Commitment Documentation in the UK, Europe and the US

Conditionality

Because a purchase agreement for an acquisition will rarely contain a "financing-out", a buyer will want to ensure that its lenders have provided a loan commitment with limited conditionality before signing the acquisition agreement. In recent years, the conditionality of lenders' loan commitments in the acquisition finance context generally follows the "certain funds" standard in the UK and the European markets and the "SunGard" standard in the US. Under "certain funds" conditionality, the lenders' commitment to fund on the closing debt are subject only to: (i) the making of certain key representations; (ii) the absence of major events of default (including insolvency proceedings or payment defaults of the acquisition vehicle); (iii) the absence of illegality; (iv) the absence of a change of control; and (v) security being granted over certain assets of the acquisition vehicle, including the shares of the target being acquired. In contrast, the "SunGard" standard of conditionality limits the conditions such that: (a) the only representations that must be must be true and correct as a condition to funding are the specified loan agreement representations (limited largely to representations relating to corporate existence, power and authority, margin regulations, solvency and anti-terrorism and corruption laws) and the specified acquisition agreement representations (limited to representations and warranties in the purchase agreement relating to the target that, if untrue, would be material to the lenders and with respect to which the buyer can terminate its obligation to the close the acquisition); (b) the collateral in which a security interest must be granted and perfected at closing includes only collateral that may be perfected by the filing of a UCC-1 financing statement or the delivery of possessory collateral such as share certificates; and (c) the only material adverse change or material adverse event ("MAC") that is a condition to funding is the MAC[10] that applies in the purchase agreement – to eliminate any potential daylight between the loan commitment and the purchase obligation.[11]

Security Principles

Lenders in the UK, the European markets and the US markets also include in the commitment documentation an agreed description of the guaranty and security principles that will apply to complete the credit support package after closing. In the UK and the European markets, the guaranty and collateral package will vary considerably depending on the applicable jurisdictions involved, given wide variance in applicable guaranty limitations and security interest legal regimes in the region. In the US, the parties often agree to limit the collateral and guaranty package, such that no security interest is required to be provided in real property valued below a certain threshold, leased real property, motor vehicles, margin stock, interests in joint ventures (and possibly non-wholly owned subsidiaries) and other immaterial assets.

Commitment Documents in Latin America

The Latin American loan market generally follows the US loan market approach to loan documentation, rather than the UK or European approach, including with respect to commitment documentation.

Closing Date Collateral and Security Principles

Similarly, commitment documents with respect to acquisition finance transactions involving Latin American targets tend to follow the US "SunGard" standard of conditionality and US guaranty and security principles framework in the acquisition context. There are, however, challenges in using the "SunGard" standard of conditionality in Latin America relating to the formulation of the closing date collateral in the conditions to closing and the security principles.

In general, most Latin American jurisdictions do not have a construct to permit all asset security under a single document or to permit perfection of a security interest by a single filing in a central filing system of varied security interests. Ordinarily, each category of collateral will require a separate security document and separate perfection steps. Notarisation and registration requirements (which require a registry to register collateral a number of days or weeks after filing, in particular for real estate) and fees may further complicate the process and make the taking of security more expensive and protracted, or outright prohibitive from a commercial standpoint.

If the acquisition target is located in Latin America, it will be important to understand, in each relevant jurisdiction (including each specific country and, sometimes, each applicable state within such country), what the target's valuable assets are given the nature of its business, the steps and timing (and related fees required) to create and perfect a security interest in each applicable category of such assets, and whether there are financial assistance (restrictions on the ability of a company to provide a guaranty in support of, or collateral to secure, indebtedness incurred to finance the purchase of that company) or other limitations on the ability of companies organised in that country to provide guaranties or credit support in the acquisition finance context. Care must be taken to formulate a closing date collateral package that will both ensure that the lenders have a security interest in the important assets of the target and ensure that perfection can be achieved on the closing date without execution risk and to frame the security principles and ongoing collateral package to protect the lenders' interest while managing transaction timing and expense. In contrast to the US market, there is no "standard" guaranty and collateral package for acquisition loans in Latin America. Such packages tend to vary from country to country and from industry to industry within each country depending on the requirements to create and perfect security interest in the assets key for that industry.

We have endeavoured here to provide an overview of considerations in several of the jurisdictions in which M&A activity and acquisition finance transactions have been active.

In Argentina, so long as a guaranty provides arm's-length benefit to the Argentine guarantor and the required corporate formalities are complied with, the guaranty will be enforceable, subject to potential avoidance, depending on the circumstances, if the guarantor enters into insolvency proceedings within two years of the guarantee being granted in the case of new debt. Also, the Argentine courts have held that some transactions in which a company has provided financial assistance to, or a guarantee for, the acquisition of its shares have violated the Argentine Commercial Companies Law ("ACC"), by violating the administrator's duties of loyalty and care and the restriction on companies giving financial assistance or providing guarantee in connection with the acquisition of their own shares. It is not possible under Argentine law for a company to grant a blanket security interest in all of its personal property assets and security will need to be provided under separate documentation for each category of collateral. Also, it is a challenge to obtain a perfected security interest in a bank account, which may require the construction of a trust and additional time and expense. Notary fees, stamp taxes and registration fees can be material in connection with secured transactions and will vary depending on the type of assets pledged and the location of the pledgor and its assets. Registration of some security interests may take between one and several months. A recent law recognises the concept of collateral agency, so lenders do not need to be a party to the local security documents and intercreditor arrangements affecting local collateral.

In Brazil, there is no requirement that a Brazilian guarantor receive corporate benefit provided that the required corporate formalities are complied with and, provided further, that a guarantee without sufficient corporate benefit may be avoided in an insolvency proceeding of the guarantor within two years of the guarantee being granted. It is not possible for a company to grant a blanket security interest in all of its personal property assets and security will need to be provided under separate documentation for each category of collateral. Fiduciary liens are the preferable security type for foreign creditors given the protection they bring in insolvency scenarios; although there has been a debate over the legality of fiduciary liens to the benefit of foreign creditors, in particular in connection with fiduciary liens on real estate due to certain restrictions on the ownership of real estate by foreign entities or individuals. Notary fees and registration fees can be material for the taking of security over real property and personal property pledges and will vary by the region where the applicable registry is located. Registration of security can take up to one month, depending on the type of security interest being registered and the location of the registry. If the borrower has outstanding indebtedness with BNDES (subject to certain exceptions), the borrower will need a waiver from BNDES for additional indebtedness, which may take some time. Notably, recent changes to Brazilian law have enhanced the attractiveness of the Brazilian legal regime to international lenders. First, foreclosing on liens over shares of publicly traded companies and other financial assets (*e.g.*, time deposits) has become quicker. Also, Brazil has recently adopted the so-called "Apostille Convention", which should facilitate and expedite the recognition in Brazil of documents executed abroad, avoiding the need for the expensive and time-consuming "consularisation" procedure.

In Chile, so long as the guaranty provides some benefit to the Chilean guarantor and the required corporate formalities are complied with, the guaranty will be enforceable, subject to potential avoidance, depending on the circumstances, if the guarantor enters into insolvency proceedings within two years of the guarantee being granted in the case of new debt. Security should be created under separate documentation for different types of assets (under different categories of pledge depending on who will have possession of the pledged asset and the type of asset). Notary fees and registration fees may apply for the taking of security over real property and personal property pledges, and registration fees will depend on the applicable registry. There are also significant limitations on the effectiveness of security interests over bank accounts, which, in practice, render such security unavailable, and Chilean law does not provide for the existence of collateral trusts.

In Colombia, per a doctrine of the Superintendence of Corporations, a parent company may guarantee the obligations of its subsidiaries, even if the corporate purpose of the guarantor does not include such power. This doctrine should be applicable even when the target is the guaranteed company, provided that the entirety of the financing is destined to pay its purchase price. In all other cases (i.e. when a subsidiary is guaranteeing the obligations of its parent company or a sister company) so long as the Colombian guarantor's corporate purpose provides such company the power to guaranty the applicable obligations, the guaranty will be enforceable as a general principle (subject to certain exceptions including, for example, if the guarantor is a simplified stock corporation (*sociedad por acciones simplificada*), or if there is a declared entrepreneurial group between the guarantor and the guaranteed entity). There is generally no prohibition on a Colombian company providing financial assistance to support the acquisition of all of its own shares, except in the case of certain specially regulated companies such as banks, insurance companies and other finance companies. However, if the target is to guarantee a partial acquisition of its own shares, minority shareholder protection rules could apply and grant minority shareholders the right to challenge the guarantee provided by the target. Security should be granted under separate documentation for different types of assets. Alternatively, a *prenda sobre establecimiento de comercio* is available in some cases to cover groups of assets, as are security trust structures. There will be notarial fees and public registry costs depending on the type of security at issue.

In Mexico, so long as the required corporate formalities are complied with, a guaranty will be enforceable, regardless of the value provided to the guarantor, subject in any insolvency to potential clawback within 270 days of the filing for the insolvency proceedings. In Mexico, a non-possessory pledge on assets and rights may generally cover all assets, except real estate, which may need a separate document and filing. As an alternative, a Mexican collateral trust structure could be used to create a security trust structure covering a substantial number of assets, but the trustee costs are significant and administration of the collateral in the trust could become onerous for the borrower. Notary fees and registration fees may apply for the taking of security over real property and personal property pledges, and registration fees will depend on the applicable registry.

In Peru, so long as the required corporate requirements and formalities are complied with, a guaranty will be enforceable, regardless of the value provided to the guarantor, subject to potential actions against the officers and board members of the company under certain circumstances, including if the guarantees create a serious risk to the credits held by other creditors. Peru also restricts the ability of a company to provide financial assistance to a party to acquire its shares, although there may be structuring alternatives to reduce the impact of these Peruvian restrictions. Peru, in contrast to many other Latin American jurisdictions, does permit a blanket security interest under a *Hipoteca sobre Unidad de Producción*, under the applicable rules provided by Peruvian Civil Code, which covers a whole production unit including different types of assets (equipment, machinery, real estate, inventory and spare parts). As an alternative, lenders and holders of debt instruments may rely on the Peruvian guarantee trust structure (*Fideicomiso en Garantía*), governed by the banking law (*Ley del Sistema Financiero y del Sistema de Seguros y Orgánica de la Superintendencia de Banca y Seguros*) and the regulations issued by the banking regulator (*the Superintendencia de Banca, Seguros y AFP*), as well as on the securitisation trust (*Fideicomiso de Titulización*), regulated by the capital markets law (*Ley del Mercado de Valores*) and the regulations issued by the securities market regulator (*Superintendencia del Mercado de Valores*). The securitisation provides to the holders of the instruments a legal protection under which the transfer of the assets to the securitisation trust may not be subject to any annulment action since the date on which such assets were transferred to the trust. The *Fideicomiso en Garantía* could be used to create a security trust structure covering a substantial number of assets, including future cash flows, with expedited enforcement proceedings and other benefits. The *Fideicomiso de Titulización* is a trust structure that also may cover different types of assets, including the future cash flows, aimed to guarantee the offering and issuance of debt instruments in the local and/or the international markets. There have been issuances of securitisation notes (*Bonos de Titulización*) that have been structured to finance future acquisitions by local investors, who act as originators of the respective *Fideicomiso de Titulización*. The securitisation has been also used to pay the bank bridge that financed the acquisition transaction by such investors, converting the indebtedness into a long-term debt. Notarial fees will be required to formalise the security agreements as public deeds and the applicable fees will depend on the notary. There are also public registry costs.

Other Latin American Structuring Considerations

In addition to the required bespoke determination of the closing date credit support and ongoing credit support for an acquisition finance loan in the Latin American market, there are additional distinct issues in Latin American jurisdictions that may impact acquisition finance transactions and which are not typically addressed in UK, European or US commitment letters.

Withholding Tax and Other Tax Considerations

The parties will need to consider, in particular, applicable withholding tax obligations and the agreements with respect to tax gross up by the borrower. In many Latin American jurisdictions, a significant withholding tax will apply to interest payments from Latin American corporate borrowers to off-shore lenders, particularly lenders that are not regulated financial institutions or lenders organised in certain locally designated "tax haven" jurisdictions.

For example, in Argentina, if a foreign Lender is a bank or financial institution under the supervision of the relevant central bank or equivalent authority of its jurisdiction and is located in a jurisdiction that is not considered to be "low tax" or a jurisdiction that is party to an exchange of information treaty with Argentina, there will be an effective withholding tax rate of 15.05%; otherwise, the effective withholding tax rate is 35%. Also, double taxation treaties may set forth ceilings to the applicable rates. The borrower may also need to pay VAT at the rate of 21% or 10.5% depending on whether the lender is a financial institution and other factors. And there may also be applicable stamp taxes in connection with the execution of the loan agreement, promissory notes and other loan documents depending on where the applicable agreement is signed and/or causes effects, and the applicable industry.

In Brazil, payments of interest to non-residents are generally subject to a 15% withholding tax, which may be reduced in the case of an applicable double taxation treaty in effect between Brazil and the country in which the foreign investor is located or increased to 25% in the case of an investor located in a tax haven jurisdiction, according to a list issued by the Brazilian tax authorities.

In Chile, interest payments by a Chilean borrower to an off-shore lender will be subject to a 35% withholding tax; provided that a reduced 4% withholding tax rate will apply to interest paid to foreign banks or financial institutions and also to bond holders, and there may be a reduced rate also if there is an applicable double taxation treaty. In addition, there may be a one-time applicable stamp tax proportional to the principal of the loan or bonds in connection with the execution of the loan agreement or a bond issuance.

In Colombia, interest payments to off-shore lenders are generally subject to a 15% withholding tax rate (even after the tax reform approved in 2018), subject to a number of exceptions. For example, loans provided by lenders located in jurisdictions with which Colombia has a double taxation treaty generally benefit from a lower rate ranging from 0% to 5% depending on the country. However, if a lender is located in a tax haven jurisdiction, the applicable rate is increased to 35%.

In Mexico, interest payments to off-shore lenders are generally subject to: a 4.9% withholding tax rate in the case of interest paid to certain financial institutions that are residents of a country that has entered into a tax treaty with Mexico; a 10% withholding tax rate in the case of interest paid to certain financial institutions that are not residents of a tax treaty partner of Mexico; a 15% withholding tax rate in the case of interest paid to reinsurance companies or interest derived from financial leases; a 21% withholding tax rate in the case of interest paid to sellers of machinery in connection with a sale on credit; a 35% withholding tax rate in the case of interest paid to other lenders; and a 40% withholding tax rate in the case of interest paid to a related party located in a tax haven.

In Peru, interest paid by a local borrower or issuer to off-shore lenders or investors (including foreign companies, investment funds, trusts, financial institutions and other entities, in each case, regardless of whether they are domiciled in a tax haven), will be generally subject to a special rate of 4.99% withholding tax (*Impuesto a la Renta*), provided that certain formalities and requirements are complied with: (i) the lender or investor is not a related party of the local borrower or issuer (if the lender or investor is related to the borrower or issuer, the withholding tax rate is 30%); (ii) the proceeds of the loan or of the issuance of the debt instruments must be used in connection with the corporate or business purpose of the borrower or issuer; and (iii) the interest rate of the loan or debt instrument should not exceed the rate of LIBOR + 7.0% (or any interest paid on a loan or debt instrument in excess of LIBOR + 7.0% will be subject to a 30% withholding tax, except in the case when the borrower is a financial institution). Early prepayment premiums may also be subject to such withholding tax. The deduction by a local borrower or issuer from its annual *Impuesto a la Renta* of the interest paid to off-shore lenders or investors will be subject to a limit calculated on the relationship between the borrower's or issuer's outstanding capital consisting of indebtedness to its net worth (sub-capitalisation rules).

In Peru, in addition to withholding taxes, VAT (*Impuesto General a las Ventas*) may also apply and should be paid by the borrower. Interest on loans granted by foreign banks and other regulated financial entities will not be subject to the Peruvian 18% VAT. If the loans are provided by an off-shore entity that is not a regulated financial entity, including a corporation, the applicable interest payments will be subject to such VAT. In the case of notes and other debt instruments that constitute *valores mobiliarios*, which requires that the issuance include 10 or more instruments, issued by public or private offering by local issuers, the interest paid to foreign investors, including those domiciled in tax havens, will not be subject to VAT. In addition, VAT will not be applicable to interest payable under local instruments that constitute *títulos valores*, in those cases where the instruments have not been placed through a public offering and have been acquired through the Lima Stock Exchange.

Foreign Exchange Controls

Similarly, foreign exchange controls may require specific structuring to comply with local requirements. Foreign exchange controls are various forms of controls imposed by a government on the purchase or sale of foreign currencies by residents or on the purchase or sale of local currency by non-residents.

In Argentina, the foreign exchange controls applicable to cross-border financings have been lifted, allowing disbursements to be made and kept abroad, and conversion from Argentine pesos to US dollars to repay or prepay financings before or after collateral enforcement.

In Brazil, remittances from Brazil to off-shore lenders will need to be registered in the Brazilian Central Bank's system. Further authorisation by the Central Bank may be required for the conversion of such Brazilian currency-denominated amount into foreign currency and its remittance abroad upon the occurrence of certain macroeconomic events (i.e., disequilibrium in the balance of payments), but the Brazilian Central Bank has shown less strict foreign exchange enforcement over time, and there is no known precedent in which Central Bank authorisation has been required in the past decades. Although the repayment of a loan by a Brazilian company is not subject to the financial transactions tax, such tax may become payable on the closing of a foreign exchange transaction for the inflow of funds into Brazil on the granting of the loan, depending on the amortisation term of the principal; under current law such tax is payable at a 6% rate if the term of the loan is fewer than 180 days, and 0% if the term of the loan is equal to or greater than 180 days.

Chile has no applicable currency control issues, but there are certain reporting requirements. The exchange rate under which Chilean pesos would be converted to US dollars, or *vice versa*, may be freely agreed upon between the parties, provided that, in extreme cases, the Central Bank may intervene to regulate such conversion rates.

In Colombia, during 2018 there was a material amendment to exchange control regulations broadening, in essence, the type of approved derivative transactions that local residents are allowed to enter into, together with reducing certain formal requirements. In terms of foreign indebtedness, foreign exchange regulations still require foreign lenders to have a Central Bank code and require notifying the Central Bank of disbursements on a loan with non-Colombian lenders and of remittance of funds abroad to repay a loan with non-Colombian lenders. Repayment of loans to foreign lenders also must be made through specified foreign exchange intermediaries or compensation accounts, which are off-shore bank accounts that are registered with the Central Bank and subject to specified reporting obligations, and set-off by the lenders will not be permitted.

In Mexico and Peru, there are no applicable currency controls.

Conclusion

Given the tremendous opportunities for Latin American M&A activity in the coming years and the important role of loan facilities in financing acquisitions, understanding the local laws applicable to acquisition financing transactions in Latin America will continue to be critically important to market participants going forward.

Endnotes

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9. *Id*.
10. A MAC condition in a purchase agreement is typically much narrower than a typical MAC condition in a loan agreement and will specifically exclude any changes from market and economic conditions, for example. Agreeing to use the purchase agreement MAC limits the lenders' ability to refuse to fund their commitments under conditions where they might otherwise not be obligated to fund under a typical loan agreement outside of the acquisition context.
11. The UK and European certain funds requirement notably does not include the equivalent of the MAC condition, given that there is rarely a MAC condition to the obligation to close the purchase under a typical purchase agreement in those markets.

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WHITE & CASE

White & Case's Latin America practice has more than 100 lawyers focusing and practising in the region across offices in New York, Miami, Washington DC, Madrid, and on the ground in Mexico City and São Paulo. We have an extensive track record of representing lead arrangers/agents and credit parties in the most complex, high-value cross-border finance transactions in Latin America, as well as advising on high-profile cross-border M&A deals. Clients value our regulatory knowledge, practical know-how and significant transactional experience gained through our longstanding presence in the region: in the last 40 years, we have won over 100 'Deal of the Year' awards in Latin America, and White & Case currently holds top-tier rankings in *Chambers Latin America* for all main areas of business law, including Band 1 rankings for Banking & Finance and Projects. As a pioneering and truly international law firm, our cross-border experience and diverse team of local, US- and English-qualified lawyers consistently deliver results for our clients in both established and emerging markets.

Developments in Midstream Oil and Gas Finance in the United States

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The robust appetite of private equity for capital to finance their growing portfolios of midstream oil and gas assets at various stages of development, construction and operation has led to a number of innovative financing structures in the sector of late.

Growth of Private Equity in Midstream Oil and Gas

The Midstream Sector At a Glance

With more than $670 billion in enterprise value in 2018, midstream has become the largest sector within oil and gas in the United States, surpassing upstream and exceeding oilfield services and refining by multiples.[1]

In terms of pipelines, the U.S. network is the largest in the world, extending over 2 million miles.[2] This network contains an extensive sub-network of gathering lines, extending from main pipelines into regional producer areas.[3] For crude, this sub-network extends over nearly 75,000 miles. For natural gas, whose development is a more recent phenomenon, the gathering line sub-network is less extensive, but growing quickly. Shipment of crude, natural gas and other related products by pipeline in the United States quite simply dwarfs all other means of transport. This sector is predicted to grow even more in the coming years. The reasons for this growth are multiple.

Growth Factors

The extensive pipeline infrastructure in the United States has allowed the oil and gas industry to thrive, connecting regional markets to other regional markets, power plants, refineries and export facilities across the United States. This has been a decade-long process, leading to a situation in which 70% of all crude, natural gas and related products are shipped by pipeline. This also means that the pipeline infrastructure in some cases is ageing, leading to leaks, ruptures and spills. Over the past decade, there have been over 3,000 pipeline spills in the United States.[4] Nearly half of pipelines are over 50 years old. Combined with the growth in the need for natural gas pipelines and gathering line networks stemming from growth in regions such as the Bakken, Eagle Ford, Marcellus, Permian and Utica shales, the need to replace ageing mainline pipeline infrastructure only points to increased capital needs for the foreseeable future.

Furthering this trend, the United States is predicted to account for more than half of worldwide growth in oil production capacity over the next five years. Fuelling this are a number of factors such as increases in oil output and the mismatch between U.S. crude production and U.S. refiner demand, discounts in U.S. crude prices relative to other producers driving export demand, and an increased demand expectation for so-called "sweet" crudes with lower sulphur content (the predominant type produced in the United States) due to international requirements and limitations on many refiners' ability to remove sulphur from crude, further driving export demand.[5]

On the natural gas side, it is predicted that more than $150 billion in midstream assets are needed over the next decade to reduce bottlenecks and move shale gas from their basins to demand centres. Operators in the Marcellus, Permian and Utica shales are already investing in regional projects to provide capacity.[6] Add to this the LNG facilities on the U.S. Gulf Coast in need of pipelines to feed exports. Over the coming two decades, nearly $800 billion is expected to be needed, given these trends.

Private Equity's Search for Assets

The growth of the midstream oil and gas sector as a financeable infrastructure asset is largely the product of a number of simultaneous developments.

The first development is on the private equity side of the equation. Private equity's overall capital pool has continued to grow over the past decade, and for infrastructure-focused funds the pool of available traditional (or "core") infrastructure assets in need of capital – or more accurately, in need of capital in exchange for rates of return sufficient to justify certain types of private equity investment – has steadily decreased. These core infrastructure assets have most traditionally encompassed toll roads, airports, rail and electric power plants. In respect of electricity generation, the plants of the base load long-term contracted variety (e.g., natural gas and coal) were eventually joined by quick-start peaking plants as well as, over the past decade, renewable projects, such as wind and solar. Beyond just the expansion of the asset class to private equity and lenders, once-routine features underpinning their bankability on a non-recourse basis (such as long-term contracted offtake agreements) have become rather rare – these assets more often than not now are "merchant", though revenues are backstopped somewhat by energy commodity hedges. But the returns for such assets have continued to move downward (absent a unique risk profile for a particular plant or a particular power market).

As the asset class has continued to mature and the inherent risks thereof have become more predictable, the market has driven down the return profiles. These developments have resulted in a search for infrastructure-focused private equity for new assets, the search for the next so-called "core plus". Commercial lenders and long-term institutional investors that focus on infrastructure have seen the same developments over the past decade – more competition for bankable assets, driving lower yields and leading to stores of capital in search of deployment.

Midstream Assets in Search of Capital

The assets that Master Limited Partnerships (MLPs) would typically acquire are of a largely midstream variety: pipelines and logistics facilities – stable income generating assets which, while beholden to swings in commodity prices and wellhead production (given their reliance on utilisation by producers sending product to market or storing it) were not as directly at-risk (usually as a result of producer diversification and minimum volume commitment (MVCs) capacity charges). Although, like the developments in the "core" power infrastructure space, the types of assets treated as "midstream" have evolved over time, moving closer and closer to the wellhead. Today, while a pipeline, terminal and storage facilities would still be quintessential "midstream" assets (as well as liquefied natural gas (LNG) facilities), the class now also includes assets much closer to the wellhead and upstream activities: gathering and processing (G&P) systems that bring crude, natural gas and natural gas liquids (NGLs) to the pipelines and water gathering and disposal systems. It is this value chain that private equity has stepped into in recent years, and with it, private equity has brought along its commercial banks and institutional investors, many of whom had seen firsthand the developments in the power sector (and the expansion of that asset class).

On the commodity front, the crude oil price downturn that began about five years ago led a number of corporates to pull back from equity markets due to capital cost increases resulting from share price decreases. The commodity prices may have risen recently, but there remains a continued desire for restraint on the part of the corporates and their MLPs. This has further contributed to an environment in which private equity has been able to make inroads.

Another development is on the corporate and tax side of the equation. Over the past several decades, oil and gas-focused corporates have binged on MLP structures, separate investment vehicles which would steadily acquire income-producing oil and gas assets (primarily midstream-style logistics operations). The payment streams from acquisitions by these MLPs would fund further development capital for the corporates; and the corporates would continue to see ongoing revenues (and maintain control over the assets) by virtue of their management interests in the MLP. MLPs have, over the past few years, seen many corporates opting to fold the vehicles back into the corporate, or have the MLP itself convert into a C-corp. And many of the remaining MLPs have begun acting much more like private equity untethered from their parent corporates, acquiring new assets from outside their corporate structure. Furthering this trend is the fact that a very attractive feature of MLPs was the tax pass-through nature of the MLPs (the MLPs themselves remained untaxed, while such taxes were passed through to the ultimate investors). Where corporate tax rates were the same or higher than corporate tax rates, a tax pass-through structure could reliably provide greater tax efficiencies. However, in addition to other recent tax law changes, the federal income tax changes in 2018, which have seen corporate tax rates fall considerably below individual tax rates, have created an environment where a corporate intends to keep captive its assets, electing S-corp rather than C-corp treatment may not have as much value, particularly when weighed against other considerations inherent in MLPs (such as the administrative burden of establishing and maintaining an MLP). Furthermore, private equity generally has a lower cost of capital (thus lowering the hurdle-rate for returns) as compared with MLPs. Additionally, private equity investors can take time to see investments through, while MLP investors tend to be quarterly-result and distribution focused. These factors have given private equity an ever-increasing opportunity to gain ground in the sector.[7]

The Field Today

As of the end of 2018, private equity gained a significant foothold in various of the key midstream regions, such as the Permian Basin and the Marcellus and Utica shales, competing with public corporates as they target existing assets and build new infrastructure.

For example, in late 2017, Global Infrastructure Partners (GIP) acquired Medallion Gathering & Processing, a midstream G&P operator of over 800 miles of crude pipelines in the Permian's Midland sub-basin in a deal valued at over $1.8 billion. Jefferies arranged acquisition financing in the form of a $725 million term loan B (TLB) facility.[8] This followed from Blackstone's acquisition of EagleClaw Midstream Ventures, a midstream G&P operator in the Permian's Delaware sub-basin, from EnCap earlier in 2017 for $2 billion with Jefferies-arranged acquisition TLB financing of $1.25 billion.[9] Also in 2017, Traverse Midstream Partners secured a $1.2 billion TLB facility, arranged by Deutsche Bank and JP Morgan Chase, to support its capital requirements relating to its interest in Energy Transfer Partners' Rover Pipeline, a $4.2 billion 700-mile gas pipeline connecting the Marcellus and Uticas shales to markets across the United States and Canada.[10]

Also in the Permian Basin, Ares Management and ARM Energy Holdings' joint venture Salt Creek Midstream began development of a gas and crude G&P system, with compression and treating facilities, secured with shipper contracts from Delaware sub-basin producers. In early 2018, Deutsche Bank arranged a $350 million term loan to finance the project.[11] Linking assets in West Texas, Ares-backed EPIC is developing a 700-mile y-grade (i.e., NGL) pipeline connecting the Permian and Eagle Ford basins to refineries and export terminals in Corpus Christi, Texas. UBS and Deutsche Bank led a $650 million TLB and $40 million super-priority revolver to finance the project.[12] A parallel crude pipeline project is also being developed by Ares-backed EPIC.[13] Later on in 2018, the Salt Creek Midstream G&P system was expanded to include additional cryo processing facilities, crude and natural gas gathering lines and water gathering and disposal infrastructure. Deutsche Bank arranged an additional $300 million for the upsized project, bringing the total financing to $650 million.[14]

Continuing the development in water asset transactions, in late 2018, Hess Infrastructure Partners, a joint-venture between GIP and Hess, moved to acquire Hess' existing water services business in the Bakken shale, comprising 150 miles of water gathering and disposal pipelines.[15] Also in late 2018, Macquarie Infrastructure Partners announced a plan to invest $500 million into Lagoon Water Solutions, backing assets in Oklahoma's SCOOP (South Central Oklahoma Oil Province) and STACK (Sooner Trend (oil field)), Anadarko (basin), Canadian (county) and Kingfisher (county)) plays, ultimately comprising 150 miles of pipelines.[16]

In respect of other midstream asset sub-classes, ArcLight Capital Partners announced in late 2018 an agreement to acquire from Targa Resources assets including a refined products and crude oil storage and terminal facilities in Tacoma, Washington and Baltimore, Maryland.[17]

These transactions are a small sampling of recent private equity activity, and the trend continues apace.

Growth of TLB Facilities on a Project Financing Basis

Development of Project TLBs

Until the 2008 financial crisis, projects benefitting from high-quality contracted revenues were financed on a single-asset or small portfolio basis by European commercial banks utilising project finance structures. In brief, project finance structures (usually term loan As (TLAs)) are characterised by substantial amortisation payments, lower, if any, balloon payment at maturity, significant lender oversight of project contracts (such as construction, operations/maintenance and revenue contracts) and direct arrangements between counterparties and lenders, control over cash flows (through a depositary-controlled waterfall), robust notice and reporting regimes and tighter covenants. A traditional project financing sees lenders financing an asset on the basis of stable contracted cash flows with creditworthy entities to ensure the project succeeds and the loan is repaid; which is the reason that project financing structures are often utilised to support under-construction projects where no project sponsor operational track record has been established. Domestic projects, such as electricity generation facilities and liquefied natural gas facilities, typically benefitted from such long-term fixed-price offtake agreements. TLA lenders (typically European commercial banks) were able to lend against a constant stream of cash flows, which covered operations and maintenance costs of the project and debt service.

Following the 2008 financial crisis, European commercial banks became subject to stricter capital and liquidity requirements, which resulted in diminished availability of such capital. Additionally, the abundance of low-cost natural gas in the U.S. market resulting from the rapid development of hydraulic fracturing technology and horizontal shale drilling drastically lowered fuel-supply costs for the power sector, but with it came declines in the price of electricity. With such lower fuel costs, natural gas power plant projects, which historically relied on revenues from long-term offtake agreements to underpin project financings, now faced a changing landscape as a result of utilities and other traditional offtakers no longer needing to lock in long-term power purchase agreements, making such assets less appealing to European commercial banks. Such banks continued to invest in high-quality contracted assets, such as large capital-intensive liquefied natural gas projects benefitting from offtake contracts with highly rated counterparties, including Osaka Gas Co Ltd. and Chubu Electric Power Co. Inc. In 2014, Freeport LNG raised approximately $11 billion, making it the "largest fully non-recourse construction project financing in history".[18] However, natural-gas power projects (some of which had been under development for years), were required to find alternate sources of capital. Commencing in 2012, Panda Power Funds was one of the first sponsors to tap the institutional investor TLB market to finance a series of greenfield limited-recourse construction financings for gas-fired generation facilities in the ERCOT and PJM power markets. By adopting structural protections typically included in project finance transactions, but retaining the repayment and covenant flexibility of traditional TLB transactions, institutional TLB investors were able to absorb the relatively higher risk of an uncontracted or partially-hedged asset, while enjoying the relatively stable returns afforded by an electricity generation facility and the lower default risk profile of a project financing. In March 2018, Moody's published its updated study, "Default Research: Default and Recovery Rates for Project Finance Bank Loans, 1983-2016" which reconfirmed, as reported by one co-author of the study, that "structural features, underwriting disciplines and incentive structures characterizing the project finance asset class have proven effective".[19]

Syndicated leverage finance TLBs, on the other end of the spectrum from project finance TLAs, rely heavily on the borrower and its ability to operate its business to drive revenues, with less oversight and control over the borrower; the key protections of lenders being excess cash flow sweeps, leverage ratios and covenant thresholds tied to the relative size of the business.

Power sector TLB financings vary, but as of 2018, they are characterised most commonly by light covenant controls over key project contracts (the number of which is fewer than a traditional project financing given the lack of revenue contracts) and the ability to replace them easily, the maintenance of an account waterfall (though in some cases permitting the borrower to itself manage the waterfall rather than a depositary bank) and the inclusion of leveraged finance-style EBITDA-based financial covenants, with excess cash flow sweeps at varying percentages. Construction-stage TLBs typically contain additional features that are more common to TLA financings; while operational power projects benefit from significant flexibility in the loan documentation.

In 2017, following the controversy surrounding the Dakota Access construction project financing involving a syndicate of TLA lenders, pipeline sponsors found the TLB market an attractive funding source. Equity investors in the Rover Pipeline, which was designed to transport 3.25 billion cubic feet per day of domestically produced natural gas from the Marcellus and Utica Shale production areas to markets in the United States and Canada, closed separate TLB financings in close succession, including the approximately $1.2 billion TLB to fund ongoing capital requirements associated with Traverse's 35% interest in the Rover Pipeline and the approximately $1.2 billion TLB to fund Blackstone's acquisition of 32.4% (net) interest in the same Rover Pipeline. In addition, in 2018, Traverse closed a $150 million term loan add-on to fund additional project costs incurred to complete the pipeline which did not impact ratings. Access to the TLB market at leverage exceeding 7× debt-to-EBITDA (projected to 5× debt-to-EBITDA by 2023) was available, in part, due to "long-dated, take-or-pay contracts having a weighted average tenor approximating 15.5 years".[20] While power projects may now access the hybrid TLB market on a "merchant" or "quasi-merchant" basis, the presence of shipper contracts representing a steady stream of revenues has remained integral to a midstream project's access to the hybrid TLB market (though the level of "take-or-pay" required is evolving).

Given the robust acquisition finance market commencing at the end of 2017 for midstream assets and the lack of capital in the public markets due to tax law changes for Master Limited Partnerships, a further evolution of the hybrid TLB financing structures accommodated the particularities of the midstream acquisition finance market.

Unique Considerations in Midstream O&G Finance Transactions

Debt financing in the oil and gas industry is one historically consisting of EBITDA-driven leveraged financings and reserve-based lending (RBL) financings, the former supporting existing operational concerns with earnings capable of repaying debt, the latter with projected oil and gas reserves providing the support for riskier upstream construction and development. In addition, Master Limited Partnerships afforded sponsors access to readily available public capital. In the past decade, with declining commodity prices, many borrowers of RBLs having become overextended, became insolvent. This resulted in an industry-wide reduction in RBLs, and while such financings continue for certain oil and gas players, they are less common.

With the coming of private equity to the midstream sector, beginning with a wave of acquisitions of existing operational concerns, such as Blackstone's acquisition of EagleClaw in 2017 and GIP's acquisition of Medallion in 2017, both noted above, the TLB market, which has developed alongside private equity in the power infrastructure sector, followed.

Midstream TLBs

The midstream sector has taken the hybrid TLB structures, and adapted the structures to meet the needs of the asset class. For some midstream assets, the structures largely fit well from the beginning. A pipeline is a project very similar in many respects to a power project. A set amount of capex is required to reach completion. Prior to completion, no revenues will flow. Cost overruns are possible but are largely a known quantum; though the sheer length of pipelines, the various terrains to be overcome, the property rights to be acquired and the fact that the production in the area serviced by the pipeline will eventually decline does create a higher level (or at least a marginally varied type) of risk as compared to a power project built on a single plot. It is no surprise then that project finance-style TLBs have been utilised to fund construction of pipelines, just as they have for construction of power projects.

In addition, by utilising project finance structural protections, sponsors seeking financing for midstream assets have been able to utilise project finance methodology to obtain higher ratings in respect of higher closing date leverage than would be available using leverage finance methodology. At a very high-level, Standard & Poor's Methodology for Project Finance Ratings requires four basic characteristics to rate a project's debt using such methodology, including limited purpose entities, senior ranking of the debt, a covenant package that limits debt, security and assets sales, insurance requirements and a traditional cash-management covenant package that governs the priority of cash payments.[21] In addition, key credit factors outlined by S&P's Key Credit Factors and Assumptions for Energy Projects take into consideration the project's customer mix, value proposition, scale scope and diversity, and its value added offerings.[22]

Private equity sponsors have, however, run into issues where they have attempted to access the TLB market too early in the construction, particularly where significant portions of property rights of way are not yet locked in. Alternatives to such a scenario, where capital is needed very early in construction, have been in the form of underwritten construction-stage bridge financings; in those transactions, bridge lenders rely on the ability of the project to, upon reaching certain milestones, be capable of accessing the TLB market for takeout financing.

Further tracking the developments in the power TLB market, which has seen a trend toward "merchant" or "quasi-merchant", there has been a move in the midstream TLB market from MVC-structured shipper contracts (the early-process midstream iteration of a "take-or-pay" contract) toward shipper contracts that rely primarily on field-wide dedications (either exclusively or with reduced MVC components) whereby all of the production from a specified geographic area (or, less commonly, a specified set of wells) will flow through a particular G&P system and/or pipeline. Some basins are more likely to be capable of supporting this structure than others. For example, where a basin's decline curves are less steep and there is a history of continued production in commodity downside scenarios (for example, West Texas' Permian Basin, and particular sub-basins therein), there tends to be a greater willingness to accept a level of production risk resulting from such structures.

One aspect of midstream TLBs that has proven interesting is that, given the size of certain pipeline projects (and the relative lack of commercial project finance availability), sponsors can tap the TLB market for leverage of JV interests. This is seen in the Traverse Midstream TLB described above.

Acquisition Financings and Construction Financings in the Midstream Sector

The TLB market has also supported acquisitions of large operating G&P assets. These assets are already operating, show historic EBITDA and are relatively straightforward to finance under a TLB structure.

As noted above, Blackstone's acquisition of EagleClaw in 2017 for $2 billion with a $1.25 billion acquisition TLB arguably began the trend. This was shortly followed by GIP's acquisition of Medallion for $1.8 billion with a $725 million acquisition TLB. ArcLight's acquisition of storage and terminal facilities in Tacoma, Washington and Baltimore, Maryland also saw acquisition financing round out the capital stack.

While there may be certain aspects of these G&P TLBs that are somewhat critical given the asset-class, for example, a need for future development and acquisition flexibility, they are not altogether unique to the sector. This additional flexibility is nonetheless worth mentioning in brief. A feature in certain midstream TLB structures is an ability on the part of the borrower to, subject to certain conditions, account for a portion of revenues of material projects under construction in EBITDA calculations. This unique accounting may be of interest in a pipeline or G&P transaction in which the business case relies heavily on continued growth and investment of the pipeline or G&P asset. As the types of transactions among midstream players continues to evolve, including in respect of joint ventures, sales of capacity on pipelines and G&P assets and trading of interests on pipelines, financing structures have and will continue to adapt to the realities of this dynamic business.

Unlike a pipeline (or a power plant), a G&P system, while it may have construction phases and growth milestones, does not necessarily achieve "completion" in the traditional sense. There is no final point at which the project is complete and revenues start flowing. It will grow to track wellhead production – expanding toward active wells as they come online – growing to suit. And as such, revenues will start trickling into the project relatively early in the construction process, which ramp up over time as the system grows. And perhaps most importantly as a structural consideration, the construction and ongoing development of the system must be nimble; project contracts will need to be entered into and revised constantly, with constant re-evaluations and re-workings of the overall design and development of the system as it develops, as new shipper contracts are obtained.

As such, a traditional project finance-style product will not provide the level of flexibility that is necessary for a G&P system undergoing construction and/or continued development. Even a project finance-style TLB might be too restrictive for the long-term; and in any event, early stage G&P systems rarely support the level of debt quantum typically needed to access the TLB market. While one option would be to arrange a short-term bridge-to-TLB financing, there are risks to both borrowers and lenders in such a scenario – namely certainty of access to the TLB market for takeout financing.

Recent financings of G&P companies have innovated to develop a loan structure very well suited to the asset class, taking a project finance-style TLB structure, with its excess cash flow sweep, and adding early-stage tight controls over project contracts, account waterfalls and reporting, all of which deactivate after certain financial metrics are met as demonstrated by the growth of the project via increased EBITDA. Essentially, once the overall debt-to-EBITDA of the project is reduced below certain pre-agreed thresholds (such that from a credit perspective the financing looks and feels more like a leverage finance loan rather than a project finance loan), the project finance technology turns off and the borrower can act more freely without lender approval and oversight, since at that point the lenders' protections are the maintenance of EBITDA; in short, the loan and corresponding credit looks and smells much more like a leveraged financing rather than a project financing at that point, and the loan is structured with built-in flexibility to accommodate that reality.

On the Horizon

The developments in the TLB market (and TLB-adjacent markets, such as commercial bank TLA and bridge loan markets that target similar assets) in recent years demonstrate an ongoing evolution in financial structuring and a willingness (perhaps even an eagerness) of the market to adapt, accommodate and absorb new types of asset classes and credit profiles. The rise of the hybrid midstream TLB, and its evolution within the midstream sector to accommodate varying asset profiles, has proven it to be a stalwart source of capital where the traditional project finance market and the equity markets have been unable to provide sufficient funds. From pipelines, to G&P systems to terminals and from crude, to natural gas, to NGLs and water, the asset base continues to grow, and the need for financing with it. And many of these assets beget a need for more assets to service them, as the infrastructure matures. In the coming 18 months, it is expected that new pipelines to the U.S. Gulf Coast will carry an additional 2 million barrels per day (bpd) of crude. But existing terminals in Corpus Christi, Texas can, today, offer only 300,000 bpd of export capacity.[23] The expansion of prolific G&P systems throughout the Permian, and in other basins, eventually give rise to significant water gathering and disposal needs. Private equity appears poised to acquire and develop these assets, as the examples of ArcLight's acquisition of Targa's terminal assets and Macquarie's investment in water service provider Lagoon demonstrate, and with that follows a need for additional leverage.

If the story of the TLB market holds, the evolution from power financings to midstream financings is unlikely to be the last chapter in the story. As the definition of infrastructure continues to expand, from "core plus" to "core plus plus" and so on, the instances where infra-focused private equity investors move into those spaces will increase, and along with them, the TLB market and related financings. One industry where private equity is steadily taking greater ground is the telecommunications industry, and in particular the broadband sub-sector. This process has already occurred in Europe but is also now occurring in the United States; and as PE-backed networks grow, consolidate and densify (due to 5G demands) their value may increasingly tempt the TLB market. As private equity moves into this space and others, lessons learned in the power and midstream TLB markets will prove invaluable in creating financing structures that can adapt to meet the unique needs of new asset classes.

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Our US oil and gas practice spans the entire hydrocarbon value chain and we have deep experience advising clients on all stages of an oil and gas project, from initial due diligence and structuring through all of the operational contracts required to manage assets and operate a domestic oil and gas project.

Our team in the US has been on the front lines of modern project financing since its advent in the 1980s and regularly represents leading lenders, sponsors, developers, investors and contractors on some of the world’s most challenging projects. This history gives us expertise with every financing solution contemplated for a project: equity financings, mezzanine financings, ECA financings, tax-exempt/private activity bonds, taxable bonds (including private placements), bank term loans, US government financings and any combination of the above.

The firm opened an office in Houston in February 2018. The office expands upon our already globally recognised oil & gas practice and adds substantial depth to our domestic and international energy practice, allowing us to involve our team in supporting US-based energy clients on their investments around the world, as well as to broaden our service offering to our clients and support them on their investments in the Americas oil & gas sector.

Margin Loans: The Complexities of Pre-IPO Acquired Shares

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I Introduction

In the United States, 2018 was a record year for initial public offerings ("***IPOs***") since the 2008 financial crisis: big names such as Eventbrite, ADT and AXA Equitable Holdings went public. This year may be another impressive year for the U.S. market, with high flying companies such as Uber and Lyft poised to go public in 2019.

Investors that acquired shares of an issuer prior to its IPO ("***Pre-IPO Acquired Shares***") may want to monetize their investments in those companies post-IPO by obtaining margin loans rather than divesting their positions. There are many banks and other lenders willing to provide such financing, since such loans are secured by highly liquid collateral, i.e., the publicly traded securities that may be quickly sold in the open market. There are, however, many legal and contractual issues that need to be addressed in structuring a margin loan secured by Pre-IPO Acquired Shares, such as registration requirements under the Securities Act of 1933 (the "***Securities Act***"), trading restrictions under the Securities Exchange Act of 1934 (the "***Exchange Act***"), margin regulations under the Federal Reserve Act and on top of all those, contractual restrictions among private parties. This article analyzes certain significant legal and contractual issues in the United States in structuring a margin loan with the focus on one critical issue: *what actions should a lender take on the front end to be in the best position to quickly sell Pre-IPO Acquired Shares that are subject to legal and contractual restrictions in a foreclosure scenario?*

II U.S. Federal Securities Laws

In the United States, sales of publicly traded securities are subject to complex regulations, including the Securities Act, the Exchange Act and the various related rules, regulations and administrative interpretations. Under U.S. laws, a foreclosure by a lender of pledged public securities constitutes a "*sale*" of securities, and in certain situations, the initial pledge of public securities could also be deemed to constitute a "*sale*" of securities. As a result, U.S. federal securities laws routinely apply to a pledge of Pre-IPO Acquired Shares securing a margin loan.

A. Registration Requirements

Section 5 of the Securities Act prohibits the sale of any securities unless such sale is made (i) pursuant to an effective registration statement filed with the Securities and Exchange Commission (the "***SEC***"), or (ii) pursuant to an exemption under the Securities Act.

If the pledged securities were initially issued pursuant to an effective registration statement, such securities are commonly referred to as "*unrestricted securities*" because they do not bear restrictive legends and can generally be freely sold by a non-affiliate holder, including a lender, pursuant to the *Section 4(a)(1)* exemption under the Securities Act. As a result, the parties to a margin loan secured by such securities may not have to be as concerned with the registration requirements of the Securities Act. Pre-IPO Acquired Shares, on the other hand, are not typically issued pursuant to an effective registration statement and are acquired in private transactions. Lenders financing such securities, therefore, need to be concerned about compliance with the registration requirements or find an exemption under the Securities Act.

Pre-IPO Acquired Shares are typically "*restricted securities*," which is defined in *Rule 144(a)(3)* of the Securities Act to include, among other things, "*securities acquired directly or indirectly from the issuer, or from an affiliate of the issuer, in a transaction or chain of transactions not involving any public offering.*" In addition to being restricted securities, some Pre-IPO Acquired Shares are also "*control securities*," which are securities owned by an affiliate of the issuer. Restricted securities and control securities may not be sold absent compliance with the registration requirements of the Securities Act or an available exemption therefrom.

Although it is possible that upon a default, a lender may register the pledged securities with the SEC and then sell such shares pursuant to the registration statement, registering the shares for resale poses a number of problems. First, filing a registration statement requires the cooperation of the issuer. Second, even if the issuer is contractually obligated to file a registration statement on behalf of the lender, such as pursuant to registration rights that are assigned to the lender in connection with the pledge, the issuer generally has rights to delay the filing of a registration statement or suspend sales under a registration statement in certain circumstances. In addition, the registration statement may also be subject to review by the SEC. Overall, the uncertainty of the cooperation by the issuer and the potential timing delays can constrain a lender's reliance on the post-default registration of the pledged securities. Furthermore, lenders may also be concerned that selling pursuant to a registration statement could cause them to be treated as underwriters that may be subject to liability under *Section 11* of the Securities Act for misstatements or omissions contained in the registration statement. As a result, before agreeing to accept securities as collateral for a loan, lenders will generally want assurances that there will be suitable exemptions from the registration requirements of the Securities Act. The most commonly used exemption for a margin loan lender is the Rule 144 safe harbor.

Rule 144 does not provide a direct exemption from the registration requirements of the Securities Act; rather, compliance with Rule 144 avails lenders of an exemption under *Section 4(a)(1)* of the Securities Act. *Section 4(a)(1)* exempts from the registration requirement transactions by any person other than "*an issuer, underwriter or dealer*." A margin loan lender can usually determine without much difficulty whether it is an issuer or a dealer with regard to the pledged securities, but the word "*underwriter*" includes "*any person who has purchased from an issuer with a view to, or offers or sells for an issuer in connection with, the distribution of any security, or participates, or has a direct or indirect participation in any such undertaking.*" The definition of "*underwriter*" may include a margin loan lender if the pledged securities are restricted or control securities. However, if a lender meets all of the applicable requirements of Rule 144, a lender selling restricted or control securities in a foreclosure sale should not be deemed an underwriter and should be exempt from the registration requirements of the Securities Act.

B. Rule 144

Rule 144 provides a series of conditions that must be satisfied for a sale of restricted or control securities to fall within the rule's safe harbor. Due to the complexities of Rule 144, a lender should always analyze the availability of Rule 144 with legal counsel.

Rule 144(b) differentiates between "*non-affiliates*" and "*affiliates.*" *Rule 144(a)(1)* defines an affiliate of an issuer as "*a person that directly, or indirectly through one or more intermediaries, controls, or is controlled by, or is under common control with, such issuer.*" A *non-affiliate* is any person who does not fall within the definition of affiliate under *Rule 144(a)(1)*. If the pledgor is an affiliate of the issuer, a number of other requirements of Rule 144 may apply, including volume limitations, current public information requirements and manner of sale requirements, but not all such restrictions will necessarily apply to a non-affiliate lender selling pledged securities following a default. To determine whether a person is an affiliate or a non-affiliate may require a complex legal analysis.

If, at the time of sale, the issuer of the pledged securities is, and has been for at least 90 days prior to the sale, subject to the reporting requirements of the Exchange Act, and the issuer is current in its reporting under the Exchange Act as provided by *Rule 144(c)(1)*, Rule 144 allows a non-affiliate lender (with the same holding period) to sell restricted securities if such securities have been beneficially owned by the pledgor for at least six months (or 12 months if the issuer ceases to be subject to the reporting requirements or is not current in its reporting). Determining the holding period is often the most significant issue in a margin loan transaction involving restricted securities.

For purposes of the holding period requirements, a lender is allowed to "*tack*" the holding period of an affiliate pledgor of restricted securities to the extent a *bona fide* loan is with recourse. In other words, the lender may add to its holding period (which begins to run on the date of the pledge) the holding period of such pledgor. However, if the loan is without recourse, a lender may not "*tack*" the holding period of an affiliate pledgor of restricted securities. It is important to note that an in-depth analysis is required in determining if a loan is recourse or non-recourse, and the pledgor's holding period does not begin to run until the pledgor has fully paid for the pledged securities.

If the pledged securities are control securities, *Rule 144(e)* limits the amount of securities that may be sold in reliance on Rule 144, which shall not exceed the amount determined based on a formula set forth in *Rule 144(e)*. In analyzing the volume limitations, a lender will also need to look at the aggregation rules of Rule 144 to determine if sales by other entities need to be aggregated with the pledgor's sales. The aggregation rules can be complex and need to be reviewed on a case-by-case basis. In addition, there are requirements under Rule 144 regarding the manner of sale and filing a Form 144(h) that a margin lender should be familiar with to the extent the lender is relying on the Rule 144 safe harbor.

As mentioned above, not all of the restrictions applicable to an affiliate-pledgor will apply to a non-affiliate lender selling pledged securities under Rule 144. For example, under guidance from the staff of the SEC, a non-affiliate lender may sell restricted securities pledged by an affiliate-pledgor under Rule 144 without regard to certain of the requirements if the securities were subject to a *bona fide* pledge with recourse; and a non-affiliate lender may sell, under Rule 144, securities acquired by an affiliate-pledgor in the open market subject only to the current public information requirement in *Rule 144(c)(1)* regardless of whether the loan is with or without recourse.

C. Margin Regulations

Pre-IPO Acquired Shares, to the extent they are publicly traded on a U.S. national exchange, will most likely qualify as margin stock under Regulation U. As a result, a lender should analyze the impact of Regulation U and Regulation X on the proposed loan. The principal purpose of Regulation U is to impose credit restrictions on U.S. lenders (other than broker-dealers) that extends credit for the purpose of buying or carrying margin stock where such credit is secured directly or indirectly by margin stock. Subject to certain exceptions, a Regulation U lender may not extend any purpose credit, secured directly or indirectly by margin stock, in an amount that exceeds the "maximum loan value" of the collateral securing the credit.

The maximum loan value of margin stock is fifty percent (50%) of its current market value. The maximum loan value of all other collateral is such collateral's good faith loan value, except for unlisted puts, calls and options, which have no loan value. A guarantee of a margin loan also has no loan value. Regulation U only has an initial maximum loan value requirement and does not require the margin requirements be maintained during the life of the loan regardless of reductions in value of the collateral due to market prices. A Regulation U lender, however, is required to revaluate the collateral on any day on which it permits a withdrawal or substitution of collateral.

Under the single credit rule of Regulation U, all purpose loans extended to a customer are treated as a single credit (other than certain syndicated facilities). The single credit rule also applies where the initial purpose credit loan to a customer was made on an unsecured basis. If a subsequent purpose credit loan to that customer is secured by margin stock, then the loans shall be combined for purposes of withdrawals and substitutions under Regulation U. In addition, if a lender has made a secured purpose loan, then a lender may only make a subsequent unsecured purpose loan to the extent that the maximum loan value of the collateral for the secured purpose loan is sufficient to cover both loans on a combined basis. In addition, the single credit rule addresses situations in which a lender makes a purpose and non-purpose loan to the same customer.

If a Regulation U lender makes a loan in excess of $100,000 secured directly or indirectly by margin stock, the borrower and the bank lender must execute and retain (but not file) a Form U-1 purpose statement. In the case of revolving-credit or multiple-draw facilities, amendments to the forms may be required upon future advances. In addition, non-bank Regulation U lenders have more complicated filing requirements if they reach certain thresholds of loan secured by margin stock.

It should be noted that the Federal Reserve Board and the staff at the Federal Reserve Board have issued a significant amount of opinions and letters that provide additional guidance on many of the complex aspects of Regulation U and should be considered when making a determination regarding the applicability of Regulation U. This is another area of law in which a lender should contact counsel that specializes in Regulation U when making loans secured by margin stock.

While Regulation U monitors U.S. lenders, Regulation X is primarily aimed at foreign purpose credits by making U.S. borrowers (and foreign persons controlled by or acting on behalf of a U.S. person) responsible for compliance with Regulation T and Regulation U, as applicable.

III Contractual Restrictions

In addition to various legal issues under the U.S. securities laws, a lender financing Pre-IPO Acquired Shares will often encounter contractual restrictions on its ability to sell the pledged securities following a default. In many cases, these types of margin loans are made to a borrower that holds a substantial position of an issuer. Typically, such positions were acquired in a private transaction that imposes a number of contractual restrictions, such as lockups, transfer restrictions and voting agreements. A lender needs to carefully analyze those issues, obtain all necessary consents and waivers and map out the procedures necessary for a foreclosure sale of the pledged securities, all of which should be completed before the lender closes the loan transaction.

A. DTC Process

Due to potential rapid changes in value of the margin stock collateral, a lender will want to be in a position to quickly sell Pre-IPO Acquired Shares in the open market without any delays. As a practical matter, a key aspect to being able to facilitate a quick and efficient public sale is having the Pre-IPO Acquired Shares dematerialized and held in the name of The Depository Trust Company ("***DTC***") or its nominee, and in an account subject to the lender's control. However, Pre-IPO Acquired Shares are usually held in certificated form and subject to legends which will need to be removed by the issuer's transfer agent for the shares to be deposited with DTC or its nominee. In order to have the legends removed, the lender will need to work with the issuer and its transfer agent to determine their requirements for removing such legends.

As previously discussed, Pre-IPO Acquired Shares are typically restricted securities. To prevent an investor from publicly selling unregistered shares without an exemption, issuers often place restrictive legends on such shares. Such legend expressly states that the securities have not been registered with the SEC and cannot be sold unless pursuant to an exemption from the registration requirements of the Securities Act. If the securities are certificated, the legend is usually printed on the back of the certificate. If the securities are electronic, the legend is also "*electronic*," i.e., the account holding such securities will be noted that such securities may not be transferred.

A lender will not be able to sell the pledged securities in the open market if the shares are subject to such a legend. Getting the restrictive legend removed and moving the shares to DTC can be a lengthy process and involves several parties. In our experience, each transfer agent will have its own unique policies regarding removing a restrictive legend and may require an opinion of counsel. But a transfer agent will ultimately look to the applicable issuer to obtain permission to remove a restrictive legend. The issuer will have its own requirements which will include satisfactory opinions from legal counsel that the shares can be sold pursuant to an exemption. Such legal opinions require analysis of complex legal issues under the U.S. securities laws, and in some cases the issuer's legal counsel may be reluctant to issue such opinions. As a result, getting a law firm to issue the requisite opinions and the issuer to issue the instructions to the transfer agent can be a time-consuming process, especially where the issuer and the transfer agent may have no incentive to expedite the process on behalf of a lender. To ensure timely closing of a margin loan, the lender will want to get the parties to commence the DTC discussions early in the diligence process.

In certain transactions, a borrower may not want to move its shares to a DTC account due to certain concerns, such as tax liability or conversion fee expenses. In these circumstances, a lender may still want to obtain all necessary form documents and all necessary signatures upfront, so upon a default the lender may submit all requisite documents to the transfer agent to move the shares to DTC without undue delay.

B. Issuer Consent

In margin loans involving Pre-IPO Acquired Shares, the issuer's role is a critical component in setting the path for an efficient foreclosure process. Sometimes without the issuer's consent, a borrower cannot even pledge its Pre-IPO Acquired Shares. The issuer's consent right may be set forth in the organizational documents of the issuer, a shareholders' agreement or other relevant documents in connection with the acquisition of the shares by the borrower. All such documents must be carefully analyzed to determine whether the issuer or any other party has any consent right to the pledge of the Pre-IPO Acquired Shares and if so, whether such consent right applies to the pledge, the potential foreclosure sale, or both. In addition, a lender also needs to determine which parties need to give their consent: the issuer, certain shareholders, or both.

In addition to potential contractual consent rights, if the issuer is in a regulated industry, there may be additional restrictions. For example, a real estate investment trust (REIT) may impose restrictions on transfer of shares to comply with statutory requirements or customary industry practices. A margin loan lender should also consider the impact of such restrictions on a potential foreclosure sale.

An issuer can also take actions post-closing that may have an adverse impact on a lender taking a pledge of a large position of shares in the issuer. As part of seeking the issuer's consent to a pledge, a lender may attempt to require the issuer to agree to a covenant not to take any actions to impair a lender's rights or interests.

C. Lock-up Period and Insider Trading Policy

If the issuer recently went public or completed an underwritten equity offering, the underwriters of the issuer customarily impose contractual trading restrictions on certain shareholders of the issuer during a "lockup period" following the offering. Under these lock-up agreements, pledges of securities are typically prohibited during the lockup period. The lockup period generally lasts for 180 days following an IPO but may be as short as 90 or 60 days following the completion of a follow-on offering. Accordingly, lenders may need to seek a waiver of any applicable lockup agreements before accepting a pledge of securities from a pledgor.

Even if a lockup agreement permits a pledge of the issuer's securities during the lockup period, the lender may not be able to sell the shares in a foreclosure prior to the expiration of such lockup period. As a result, depending on the length of the remaining lockup period, the lender may want to obtain a waiver from the underwriters for both the pledge and a potential foreclosure sale by the lender of the securities.

If the borrower is an insider (such as directors or officers, etc.) of the issuer and the issuer has an insider trading policy in place, the lender should request a copy of such policy to verify that such policy would not prohibit the pledge and potential foreclosure sale of the shares. It is good practice to ask the issuer to acknowledge in the issuer consent that the insider trading policy does not prohibit the margin loan transaction.

D. Shareholders' Agreement

When an investor acquires a large position from the issuer or an affiliate of the issuer in a private transaction, such investor, the issuer and other major shareholders often enter into a shareholders' agreement, which may cover a variety of issues among the signing shareholders, such as voting rights and obligations, share transfers restrictions and registration rights. For example, the shareholders' agreement may prohibit the borrower from transferring (including by pledge) any shares for a certain period of time and may include drag along or tag along rights that further complicate transfers of the issuer's shares. Any restrictions related to a lender's ability to sell the shares need to be carefully analyzed. Fortunately, most shareholders' agreements are structured to expire upon the consummation of a "qualified offering," which is generally defined as an IPO. In summary, a lender must carefully analyze whether a shareholders' agreement affects the proposed margin loan, and if so, what waivers or consents the lender needs with respect to the margin loan and who should grant such waivers or consents.

An issuer and the non-borrower shareholders of the issuer may not be motivated to grant the borrower and the lender any necessary consents, and negotiating such consents may be a lengthy process. This is another area that needs to be considered upfront in structuring the margin loan, and a lender should get the process started as early in the transaction as possible.

E. Borrower's Organizational Documents

Sometimes the borrower itself is an entity that has multiple members or partners. The borrower and such members or partners may have their own complex agreements on how to deal with the pledged securities. Such agreements may be in the organizational documents of the borrower or a shareholders' agreement among the borrower's constituents, as opposed to a shareholders' agreement among the issuer and its shareholders.

The agreements among a borrower's own members or partners also need to be thoroughly analyzed. Such documents may contain specific provisions related to the pledged securities, including provisions related to transfer, voting rights and distributions of proceeds from transfers. In addition, the pledge of the securities may require consent of the other members or partners of the borrower, even if those are minority members or partners. Again, all necessary consents and waivers should be obtained from all applicable parties prior to closing of the margin loan.

In addition to governing a transfer of the pledged securities, a borrower's organizational documents may also cover other issues, such as the application of any proceeds of the loan and the application of excess proceeds upon a foreclosure sale. These issues may also need to be considered to avoid any potential disputes by the members or partners of the borrower.

F. Multi-Jurisdiction Issue

It is often the case that the issuer, the borrower and other major shareholders are not located in the same jurisdiction, and the issuer's organizational documents, the shareholders' agreement and the borrower's own organizational documents are governed by laws of different jurisdictions. In this case, the lender needs to engage counsel from multiple jurisdictions to analyze those documents and the relevant issues.

IV Conclusion

This article provides a summary of certain significant U.S. legal and contractual issues involved in financing Pre-IPO Acquired Shares. Pledges of Pre-IPO Acquired Shares may present certain complexities under the U.S. securities laws, such as eligibility under Rule 144 and Regulation U compliance, and contractual restrictions. As a result, an appropriately structured margin loan secured by Pre-IPO Acquired Shares requires not only thorough analysis of multiple issues under the U.S. securities laws, but also comprehensive review and analysis of various contractual restrictions.

As a note, this article does not attempt to address all relevant issues involved in structuring a U.S. margin loan. For example, it does not discuss the anti-fraud provisions of the U.S. securities laws, safe harbors under the U.S. Bankruptcy Code, or applicability of the Hart Scott Rodino Antitrust Improvements Act, nor does it analyze eligible margin loan treatment under Basel, perfection or enforcement under the Uniform Commercial Code, or U.S. state securities laws, which should all be considered in structuring a margin loan.

Note

This article does not constitute a legal opinion related to any of the subjects or topics mentioned herein.

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Credit Agreement Provisions and Conflicts Between US Sanctions and Blocking Statutes

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Introduction

Most credit agreements contain representations and covenants affirming, requiring or prohibiting actions by the credit group, including general provisions regarding compliance with applicable laws. Under current market standards for US law-governed credit agreements, most lenders also expect to receive specific representations and covenants from the credit group with respect to compliance with sanctions laws and regulations promulgated by sanctions authorities in the US, EU, the United Nations Security Council and the UK. While US entities should be familiar with US sanctions restrictions and would generally have policies and procedures in place to ensure compliance, the same credit agreement provisions often apply to non-US subsidiaries and sometimes to their affiliates. For a multinational entity, this expanded group could include far-flung foreign subsidiaries as well as their officers, directors and employees, thereby creating potential monitoring issues for entities and individuals that would not necessarily expect to be restricted from doing business with persons sanctioned under US law. As a result, not only might a non-US entity inadvertently fail to comply with credit agreement sanctions provisions, but in some cases it may also be bound by foreign laws that are inconsistent with, or in some cases contravene, certain US sanctions, thereby leading to potential conflicts with US law.

A. US Sanctions Regime

Economic and trade sanctions are administered by the United States government (the "US") primarily (though not exclusively) through the Department of State, the Department of Commerce and the Office of Foreign Assets Control ("OFAC"), an agency within the Department of the Treasury. The US utilises sanctions to implement US foreign policy and national security goals. Each sanctions programme targets specific countries, regimes, industries and related entities and individuals and addresses different objectives. Sanctions programmes are supported by one or more statutory authorities, including the International Emergency Economic Powers Act, which grants authority to the President of the United States that "may be exercised to deal with any unusual or extraordinary threat, which has its source in whole or in substantial part outside of the United States, to the national security, foreign policy, or economy of the United States…".[1] Among other things, US sanctions prohibit US persons from engaging in specified transactions with foreign persons and entities that are included on OFAC's Specially Designated Nationals and Blocked Persons List (the "SDN List"). Sanctions can be comprehensive or limited to specific individuals or entities, or to specified agencies, instrumentalities or industries of a target country or regime. They can also take different forms: primary sanctions (addressed to activities of US persons); and secondary sanctions (addressed to activities of non-US persons).

Primary sanctions are those that apply to activities of US persons that have a direct jurisdictional nexus with the United States. The scope of US persons that are subject to OFAC regulations and other sanctions regimes is broad. It includes US citizens and permanent resident green card holders wherever located, US registered entities and their foreign branches, foreign persons to the extent of their activities while physically located in the US and, in certain cases, foreign subsidiaries that are owned or controlled by US persons. The individual sanctions programmes operate to prohibit or restrict economic activity between US persons or entities and a sanctioned country or sanctioned persons, entities or industries.

Secondary, or extra-territorial, sanctions have an impact on an even broader group of persons. They are intended to deter certain activities of non-US persons that may not otherwise be subject to US jurisdiction with a goal of further isolating the target of the sanctions. Since they indirectly target foreign individuals and entities for engaging in activities with countries, entities, individuals or industries that are subject to US sanctions, they can potentially sweep into their net transactions with no direct nexus to the US. For example, a foreign entity that engages in a sanctionable activity with Iran outside of the US in a transaction that does not involve US persons could potentially expose itself to sanctions by the US, notwithstanding such foreign entity's lack of direct activities with US persons. This connection to the US can result from the foreign person's efforts to access the US financial system or otherwise conduct business in a way that indirectly relates to US persons. The potential scope of secondary sanctions expands in concert with the growing list of sanctioned countries, individuals and entities.

The use of secondary sanctions by the US is on the rise. An example of new sanctions legislation is the Countering America's Adversaries Through Sanctions Act, which became law in August 2017 and imposed secondary sanctions targeting Iran, Russia and North Korea and related persons and entities. Throughout 2018, further sanctions were imposed against specified Russian individuals and entities as punishment for allegedly meddling with the US 2016 presidential election (though a number of these additional sanctions were subsequently lifted), although such sanctions do not prohibit US entities from generally engaging in business with Russia. For example, secondary sanctions targeting Russia can be imposed against any person who knowingly engages in significant activities undermining cybersecurity on behalf of Russia or in transactions with persons that are part of the Russian government's defence or intelligence sectors. Sanctions have also been imposed or expanded by the US against Syria, Cuba and Venezuela. Recently, much attention has been focused on the US sanctions that were reimposed against Iran in connection with the US withdrawal from the Iran nuclear agreement, including secondary sanctions prohibiting, among other things, transactions with or the provision of financial messaging services to the Central Bank of Iran and other Iranian financial institutions, and the trading and transportation of Iranian petroleum products. This has had a direct impact on the other agreement signatories, as it significantly increased the risk of foreign countries, persons and entities acting in contravention of secondary sanctions as a result of their commercial dealings with Iran.

OFAC has the power to bring enforcement actions, issue civil penalties and, together with the Department of Justice, initiate criminal actions for primary sanctions violations. A number of financial institutions have been subject to sanctions-related enforcement actions in recent years. Most actions involve inadvertent violations such as inadvertently processing transactions through US financial institutions on behalf of corporate customers owned by entities and individuals on the SDN list, and have been settled with OFAC for relatively small amounts or just a warning. Wilful conduct, such as directly processing US financial transactions for sanctioned Iranian entities, can result in much more substantial penalties. If a foreign individual or entity not otherwise subject to US jurisdiction engages in restricted conduct with a sanctioned person, it would not be subject to administrative or criminal enforcement by the US since such foreign person or entity cannot "violate" US secondary sanctions by engaging in such sanctionable activity. The most common repercussions for a foreign person or entity that acts in contravention of US secondary sanctions would be the imposition of restrictions upon their ability to conduct business in the US. This could result, for example, in being excluded from accessing the US financial systems, limited or blocked in its ability to receive exports from the US, denied assistance from the US Export-Import Bank or prohibited from contracting with the US government. Individuals could have their visas revoked or be otherwise excluded from the US, and any property owned by such individual or entity located in the US could be frozen. Secondary sanctions may also impact the willingness of US persons to engage in commercial dealing with non-US persons because of concerns that such US counterparty would themselves indirectly be operating in contravention of primary sanctions. As an example, a US person could be held liable for financing or "facilitating" a commercial transaction by a non-US person that would be prohibited if conducted by a US person.

B. Blocking Statutes

Numerous countries have objected to attempts by the US to impose its sanctions laws on an extraterritorial basis – that is, to purport to restrict the activities of non-US persons. In response to the US secondary sanctions, some countries have enacted "blocking statutes" to address the impact of such sanctions on local individuals and entities. Examples of blocking statutes include Canada's 1992 Blocking Order (the "1992 Blocking Order"), which was enacted pursuant to Canada's Foreign Extraterritorial Measures Act ("FEMA"), an enabling statue that allows the Canadian government to pass orders blocking the effects of extraterritorial sanctions. In a commercial loan transaction, for example, if any of the credit parties are Canadian entities they will be subject to blocking statutes promulgated under FEMA, potentially setting up a direct conflict between compliance with credit agreement provisions and compliance with applicable law of their home jurisdiction.

The 1992 Blocking Order was intended to block the application in Canada of the US embargo against Cuba. It requires Canadian corporations and their directors, officers and employees to notify the Attorney General of Canada of any "directive, instruction, intimation of policy or other communication relating to an extraterritorial measure of the United States in respect of any trade or commerce between Canada and Cuba that the Canadian corporation, director or officer has received from a person who is in a position to direct or influence the policies of the Canadian corporation in Canada"[2] and prohibits such Canadian entities and individuals from complying with such extraterritorial sanctions. It also requires Canadian entities and individuals to report any such sanctions compliance requests to the Canadian Attorney General.

Similarly, in 1996, the European Union (the "EU") established Council Regulation (EC) No 2271/96 (the "EU Blocking Statute") to address the challenges faced by EU persons engaging in international trade and commerce that was subject to the extraterritorial application of US sanctions then existing against Cuba, Libya and Iran. Such EU persons include, among others, residents in the EU, companies incorporated in the EU (including EU subsidiaries of US-incorporated companies with their principal place of business in the EU but excluding EU branches of US-incorporated companies), nationals of an EU Member State, shipping companies established outside the EU and controlled by nationals of EU Member States and any other natural persons within the EU, including territorial waters and air space ("EU Operators"). In response to the US withdrawal from the Iran agreement, the EU Blocking Statute was amended on June 6, 2018 to include within its scope all of the reimposed US-Iran sanctions with effect from August 7, 2018.

The aim of the EU Blocking Statute is, among other things, to address the impact of US extraterritorial sanctions on EU Operators doing business with Iran and other countries subject to US sanctions that is otherwise permitted under EU regulations. Given the EU's existing commitment to the Iran agreement, it does not believe that its domestic operators should be subject to restrictions imposed by US extraterritorial legislation. The EU Blocking Statute attempts to block the application of the US sanctions that would restrict EU Operators from doing business with Iran. It further imposes an obligation on EU Operators to notify the European Commission if their economic and financial interests are impacted by any US sanction covered by the EU Blocking Statue. As the US increases its pressure on Iran through additional secondary sanctions, EU Operators are put in the unenviable position of having to choose between compliance with US law and compliance with the laws of their home jurisdiction. Since an EU Operator that is a subsidiary of a US entity is considered a US person for purposes of US sanctions laws and an EU person for purposes of EU law, it would be in direct conflict with the EU Blocking Statute if it restricts its business with Iran in order to comply with US primary sanctions. This conflict is increasingly a matter of focus for both lenders and multinational borrowers.

C. Potential Conflicts

The conflicting rules between the US secondary sanctions and the EU Blocking Statute create theoretical conflict of laws issues, but more importantly, they create practical challenges for EU Operators that go to the core of their commercial operations. EU operators that conduct their business in compliance with EU law may potentially face retaliatory consequences from the US for engagement in activities that are contrary to US policies. An EU financial institution may opt to stop processing financial transactions with Iranian entities, for example, but if it does so in order to avoid US secondary sanctions it would be in breach of the EU Blocking Statute. EU exporters conducting business with Iran in compliance with EU law may find their access to the US financial system and access to US bank accounts restricted, which can create cash flow issues for the company. Similarly, EU Operators may be unable to receive payments from their Iranian customers or contributions from Iranian shareholders if such customers and shareholders no longer have access to SWIFT (the Society for Worldwide Interbank Financial Telecommunication). This tension may force companies to rethink the way they do business. While many EU Operators have stopped doing business with Iran in the wake of the latest round of US sanctions, some companies have been reluctant to submit to the pressures of the US to isolate Iran from international trade and restrict its access to financial systems. Given the threat of being excluded from the US banking system, the prevalence of the US dollar in global trade, the possibility of being penalised for engaging in transactions with an SDN and the possibility that key corporate officers may be prohibited from entering the US, it can be anticipated that most EU Operators, including European banks, are likely to adhere to the US-Iran sanctions, even if that means acting contrary to the EU Blocking Statute.

D. Credit Agreements

Banks and other financial institutions are affected by sanctions more than operators in other industries and bear the heaviest burdens both with respect to blocking property and property interests of those on the SDN List and monitoring transactions to ensure compliance with sanctions regimes. Banks and other financial institutions are extremely sensitive to the reputational risk and civil fines and potentially criminal penalties resulting from non-compliance with US sanctions. As a result, in recent years, there has been increased scrutiny by lenders regarding compliance with sanctions-related representations and covenants in credit agreements. Credit agreements typically contain representations that the borrower and all or a specific subset of its subsidiaries (the "Credit Group") are in compliance with all laws that are applicable to the Credit Group and their properties and specifically that such Credit Group and its directors, officers and employees, and in many cases, agents and affiliates of the Credit Group are also in compliance with certain economic or financial sanctions. Whether the representations regarding compliance by agents and affiliates, and in certain cases, employees, are qualified by knowledge is a negotiated point and the outcomes vary depending on the strength of the relationship and relative negotiating leverage among the relevant borrower and their lenders. As sanctions regimes generally impose strict liability for lenders and compliance is generally unqualified, lenders have legitimate concerns about being held directly liable for financing or facilitating violations of sanctions. As such, lenders would want the sanctions representations and covenants to apply as broadly as possible to all applicable jurisdictions, while borrowers would seek to limit the scope to key sanctions regimes only, such as those that are administered or enforced by the US, the United Nations Security Council, the EU and the UK. A broad jurisdictional scope may be problematic for a multinational company where, on the one hand, certain of its subsidiaries are required to comply with US sanctions laws, and, on the other hand, other subsidiaries are prohibited from complying with US sanctions laws due to the application of blocking statutes that prohibit such compliance.

Given the complexities arising from multinational companies operating in different countries that have their own specific sanctions regimes or blocking statutes, it is appropriate for sanctions representations and covenants in credit agreement to be tailored to the specific circumstances of each Credit Group and the syndicate of lenders party to such credit agreements. By way of example, if the Credit Group includes both US and Canadian subsidiaries, it would be problematic for Canadian subsidiaries to be subject to a sanctions representation or covenant that includes compliance with US sanctions against Cuba and Canadian credit parties might request a related carve out. This is because Canada's 1992 Blocking Order prohibits compliance by Canadian entities with US sanctions targeting Cuba. Similarly, under section 7 of the German Foreign Trade Ordinance, German nationals and German branches of foreign organisations (so long as such German branches are managed in Germany and maintain separate accounts) are prohibited from participating in a boycott against foreign trade. As a result, it may be prudent to carve out German credit parties with respect to representations and covenants relating to compliance with US sanctions against Iran. As a general matter, where such conflict of laws may exist, one possible approach is for the applicable representation and covenant that is made by or with respect to such non-US person to be qualified by and be subject to any foreign laws that are applicable to such non-US person. Entities and individuals may also apply to OFAC for the issuance of licences to engage in transactions that otherwise would be prohibited. For example, certain individuals and organisations, such as those on the SDN List, are prohibited from receiving US exports. If there are transactions that may be lawfully undertaken by specified subsidiaries in the Credit Group (e.g. limited activities that are permitted under a licence), such activities will need to be appropriately carved out from restrictions relating to the sanctions regimes that are the subject of the sanctions representation and covenant.

Credit agreements also typically contain a representation and an affirmative covenant that proceeds of the loans will not be used in violation of sanctions. One often negotiated point between lenders and the Credit Group is whether the Credit Group can rely on a knowledge qualifier as to how the loan proceeds are used. From the perspective of a lender, the preferable position would be a flat representation and covenant that requires the Credit Group and its directors, officers, employees and agents not to use loan proceeds to directly or indirectly finance or facilitate any activities, business or transactions of or with any person or country subject to sanctions. On the other hand, a borrower would prefer the representation and covenant to be qualified by knowledge (i.e. the formulation to read "directly or, to its knowledge, indirectly") for the practical reason that a Credit Party cannot make meaningful representations or covenants about downstream or indirect uses of proceeds undertaken or to be undertaken without its knowledge or control. Negotiations on the inclusion of any knowledge qualifier will ultimately depend on an "allocation of risk" analysis as between the lenders and the Credit Group, as well as negotiating leverage and client relationships. Financial sponsors, which banks count among their best customers, routinely see knowledge qualifiers and more narrowly defined references to sanctions regimes in the credit agreements of their portfolio companies due to their close relationship with the banks and relatively strong negotiating leverage.

Although lenders conduct rigorous "know-your-customer" diligence on their customers, the strict liability nature of many sanctions regimes means that such diligence will not protect lenders against liability if they are found liable for violating such sanctions. Expectations regarding sanctions diligence vary widely, both amongst lenders and among borrowers. The scope of sanctions diligence often depends on the nature of the underlying transaction and the intended use of loan proceeds and generally focuses on issues (with respect to the Credit Group and, if applicable, the target in an acquisition financing) relating to the type and geographic scope of the business it conducts and the Credit Party's legal and compliance policies and procedures. Such issues include personnel training requirements, whether there are business transactions, direct or indirect, with sanctioned individuals, entities, countries or regions and whether the company has made sanctions-related disclosures or has been subject to related investigations or penalties in the past. If, for example, the borrower (and target, in an acquisition financing) is a US company that has no direct international operations, and does not conduct international business through third parties, or if the proceeds of loans under a credit facility are being used exclusively to repay indebtedness that is specifically identified, the lenders may opt to undertake more limited diligence. Under other circumstances, lenders need to conduct more robust diligence to understand the borrower's (or, if applicable, the acquisition target's) potential connection to sanctioned countries, regions, entities and individuals and the manner in which the loan proceeds will be used.

In addition, credit agreements typically contain an affirmative covenant that the Credit Group will maintain in effect and enforce policies and procedures that are designed to ensure compliance by such Credit Group and the directors, officers, employees and agents of such Credit Group with applicable sanctions. Prior to agreeing to such covenant, it would be prudent for counsel to confirm with its borrower clients that they do, in fact, have policies in place to promote compliance with the sanctions regimes that are within the scope of the sanctions representations and covenants. It is also important for borrowers to periodically update their internal policies with respect to sanctions compliance in a way that is appropriate for the current legal landscape and that will enable the Credit Group to comply with both their legal and contractual obligations.

E. European Union

In an attempt to navigate conflicts between US and EU laws, the EU Blocking Statute contains a mechanism to allow an EU Operator to seek authorisation from the EU Commission to permit it to comply with US sanctions. EU Operators requesting the authorisation must specifically identify the US sanction listed in the EU Blocking Statue that they are seeking to fully or partially comply with. The onus is on the applicant to demonstrate how non-compliance with US sanctions would cause serious harm to the interests of either the EU Operator or the EU. To determine whether "serious harm" will occur within the circumstances presented by the applicant, the EU Commission will consider, among other things, the nature and origin of the damage to the EU Operator's or the EU's interest, whether there is substantial nexus between the EU Operator and the US and any preventative measures that could be taken by the EU Operator to mitigate the resulting damage or the effects on the economic activities of the EU Operator from non-compliance with the applicable US sanctions.

Notwithstanding the existence of the EU Blocking Statute, EU Operators are free to conduct business in accordance with their own corporate policies and practices as they may independently discontinue doing business with Iran based on commercial considerations, such as perceived credit risk of an Iranian counterparty or other geopolitical concerns with doing business in the Middle East. At this stage, it is not clear if many EU Operators will seek authorisations under the EU Blocking Statute for permission to comply with US sanctions.

F. Conclusion

The conflicts between US secondary sanctions and non-US blocking laws create compliance issues for multinational companies with operations in the US and in non-US jurisdictions, which may affect their ability to make sanctions-related representations and comply with sanctions-related covenants in their credit facilities. As it is typical for representations (including the representation with respect to sanctions) to be brought down with each borrowing under the credit agreement and for the Credit Group to confirm that there are no outstanding defaults, multinational companies with subsidiaries in both the US and non-US jurisdictions that are seeking access to funding must also carefully consider whether the Credit Group as a whole is able to make such representations and comply with such covenants on a going-forward basis or whether, as noted above, specific exceptions are required for certain subsidiaries. Without question, potential exposure to secondary sanctions introduces an added level of complexity to the competing concerns of lenders and borrowers in the commercial loan context. However, it is important to keep in mind that while Iran, for example, is subject to comprehensive US sanctions, there are other situations where US sanctions may apply only to certain individuals, entities and business sectors of a sanctioned country without prohibiting *all* business activities with that country. This means that a "one size fits all" approach to dealing with compliance with sanctions laws in credit agreements may not always result in outcomes that are workable for all parties, and care should always be taken to tailor credit agreement terms to address both the concerns of the lenders and a particular Credit Group's business realities.

Endnotes

1. International Emergency Economic Powers Act (IEEPA), 50 U.S.C.A. §§ 1701 (West 2019).
2. Foreign Extraterritorial Measures (United States) Order, 1992, SOR/92-584 (Can.).

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SOFR So Good? The Transition Away from LIBOR Begins in the United States

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Introduction

Since the 1980s, the London Interbank Offered Rate ("LIBOR"), the benchmark index that reflects the rate at which banks borrow money from each other on an uncollateralised basis, evolved to become the foundation on which interest rates on various loans and financial transactions throughout the world are calculated. LIBOR is determined by taking the average value of the actual or estimated interest rates leading global are paying to borrow from one another, which were reported daily. Following the financial crisis of 2007–2008, LIBOR's reputation was damaged by charges that such reporting banks manipulated the rate before and during the financial crisis, taking larger profits from derivatives based on the manipulated rates. By 2012, regulators in a number of countries, including the UK Serious Fraud Office and the United States Congress had commenced investigations into LIBOR manipulation. As a result, in 2014, the Intercontinental Exchange ("ICE") assumed administration of LIBOR, and the ICE Benchmark Administration ("IBA") established a new oversight committee and introduced new surveillance systems and analysis techniques which subjected LIBOR submissions to closer scrutiny.

Faith in LIBOR as a reliable reference rate, however, quickly declined after the manipulation charges were acknowledged in the public domain and as a result, in 2014, the Board of Governors of the Federal Reserve System and the Federal Reserve Bank of New York (the "New York Fed") convened the U.S. Alternative Reference Rates Committee ("ARRC") in order to identify an alternative to U.S. Dollar LIBOR. In July 2017, the UK's Financial Conduct Authority announced that LIBOR would be phased out by 2021.

2018 Developments – Alternatives to LIBOR

At the beginning of April 2018, the New York Fed took the first significant step towards the transition away from LIBOR by publishing three alternative reference rates. The alternative reference rates are based on overnight repurchase agreement transactions which are collateralised by U.S Treasury securities. Each of the alternative reference rates are calculated based on transaction data from an underlying liquid market rather than subjective input. LIBOR, on the other hand, is formulated from pricing contributions from 17 panel banks rather than robust transaction data.

The first alternative rate is the Tri-Party General Collateral Rate ("TGCR"), which is a measure of rates on overnight, specific-counterparty tri-party general collateral repurchase transactions secured by Treasury securities. The underlying securities of a general collateral transaction are not identified until the terms of the trade are agreed to. The TGCR is calculated as a volume weighted median of transaction-level tri-party repurchase data collected from The Bank of New York Mellon.

The second alternative rate is the Broad General Collateral Rate (the "BGCR"), which is a measure of rates on overnight Treasury general collateral repurchase transactions. The underlying securities of a general collateral transaction are not identified until the terms of the trade are agreed to. The BGCR is calculated as a volume weighted median of transaction-level tri-party repurchase data collected from The Bank of New York Mellon as well as GCF repurchase transaction data obtained from DTCC Solutions LLC.

The ARRC, which was formed by the New York Fed to address the discontinuance of LIBOR, identified the third, and now leading, alternative reference rate as the Secured Overnight Financing Rate ("SOFR"). SOFR is an index that reflects a broad measure of the cost of borrowing cash overnight collateralised by Treasury securities. SOFR includes all trades in the BGCR plus bilateral Treasury general collateral repurchase transactions cleared through the Delivery-versus-Payment service offered by the Fixed Income Clearing Corporation. The New York Fed has supported the adoption of SOFR as the leading index for U.S. dollar-based derivatives and loans to replace the dependence on LIBOR before the 2021 LIBOR phaseout deadline.

The framework needed to transition to SOFR is well under way. The Federal Reserve Bank has begun publishing SOFR, industry organisations have published papers and advisories setting forth best practices for transitioning to SOFR and institutions are establishing internal procedures to adapt to the adoption of SOFR. In addition, certain finance transactions have recently closed utilising a SOFR construction as the benchmark rate, including issuances by Fannie Mae, Freddie Mac, Federal Home Loan Bank, Toyota Motor Credit Corporation, and New York's Metropolitan Transit Authority, among others.

LIBOR Fallbacks – The ARRC Consultations

The ARRC held a public roundtable on July 19, 2018, to recap the LIBOR succession plan and educate the financial market on contract fallback language for Floating Rate Notes ("FRN"), corporate loans, securitisations and derivatives which should properly document the transition to a new reference rate. Following the roundtable, in September of 2018, the ARRC went on to publish a series of consultations on LIBOR fallbacks, including a Floating Rate Note consultation, a syndicated loan consultation, a bilateral loan consultation and a securitisation consultation. Each consultation addresses the question of what rate does a loan fall back to when LIBOR disappears, and concludes that a SOFR-based successor rate is appropriate. LIBOR fallback language is comprised of three components: first, a trigger event to prompt the transition from LIBOR to a replacement rate; second, a successor rate to actually replace LIBOR in the contract; and third, the process by which the replacement rate is implemented.

The Trigger

The trigger event which prompts the conversion from LIBOR to a new reference rate will most commonly be LIBOR cessation, but may include pre-cessation triggers in the event of a temporary discontinuation of LIBOR, an unannounced stop to LIBOR or a material change to LIBOR. In each consultation, the ARRC identifies the occurrence of one or more of five events as a "Benchmark Discontinuation Event": (1) a public statement/publication of information by the benchmark administrator that it has or will cease to provide the benchmark, provided that at the time there is no successor administrator to continue to provide the benchmark; (2) a public statement/publication of information by the regulatory supervisor of, central bank for the currency of, insolvency official/ resolution authority/or court with jurisdiction over the benchmark administrator, stating that the administrator has or will cease to continue to provide the benchmark, provided that at the time there is no successor administrator to continue to provide the benchmark; (3) the benchmark rate is not published for five consecutive business days and is not temporary as declared by the benchmark administrator or regulatory supervisor and cannot be determined by reference to an interpolated rate; (4) a public statement/publication of information by the benchmark administrator that is has invoked or will invoke its insufficient submissions policy; or (5) a public statement/publication of information by the regulatory supervisor for the benchmark administrator announcing that the benchmark is no longer representative or may no longer be used.[1]

The Successor Rate – SOFR

Each ARRC consultation looks primarily to SOFR as a first line replacement rate for LIBOR. The approach differs for each product, with two approaches to implementing LIBOR fallback language emerging – the amendment approach and the hardwired approach. Since SOFR, unlike LIBOR, is an overnight, secured rate, it is likely to be lower than LIBOR, which also presents the need for a spread adjustment, incorporated into the fallback mechanics, to account for some of the differences between SOFR and LIBOR and to make SOFR comparable to LIBOR as an effective replacement rate. The approaches, mechanics and terms are generally similar, but differ depending on the financial product, in order to adapt to specific circumstances and applicable contracts.

Floating Rate Notes and Securitisations

For FRN and securitisations, the ARRC proposes a hardwired approach employing fallback provisions in the form of a waterfall of possible successor rates together with a spread adjustment. The waterfall, or "hardwired" approach, varies in each consultation. For FRN and securitisations, the waterfalls are essentially the same, with the exception of an additional Step 3 comprised of Spot SOFR for FRN for a total of six steps rather than five.

The FRN Replacement Benchmark Waterfall includes six steps for determining the replacement rate: Step 1: Term SOFR recommended by the relevant government body plus spread; Step 2: Compounded SOFR plus spread; Step 3: Spot SOFR plus spread; Step 4: a replacement rate recommended by the relevant governmental body plus spread; Step 5: ISDA replacement rate at such time plus spread; and Step 6: a replacement rate determined by the issuer or its designee plus spread.

For securitisations, the ARRC proposes a five-step replacement benchmark waterfall: Step 1: Term SOFR plus spread; Step 2: Compounded SOFR plus spread; Step 3: a replacement rate recommended by the relevant governmental body plus spread; Step 4: ISDA replacement rate at such time plus spread; and Step 5: a replacement rate proposed by the designated transaction representative (as identified in the relevant transaction documents).

In December 2018, the Structured Finance Industry Group ("SFIG") published a LIBOR Task Force Green Paper setting forth recommended best practices for the transition from LIBOR to a new benchmark.[2] The recommendations focus on new securitisations (non-legacy) and proposes fallback language for US securitisation transactions. Much like the proposal set forth in the ARRC securitisation consultation, the SFIG recommendation is based on a benchmark discontinuance event (including pre-cessation triggers) that serves as a trigger to transition from LIBOR to a waterfall of fallbacks, beginning with a forward-looking Term SOFR-based benchmark, then a daily Compounded SOFR or average daily SOFR, then an overnight SOFR rate and ending with an alternate rate approved by an investor vote if SOFR is unavailable. A tiered approach to determining the spread, while also preserving the sponsor's ability to designate a proposed spread, subject to investor approval, is also suggested.

Corporate Loans and Bilateral Loans – The Amendment Approach *vs*. the Hardwired Approach

For the loan market, two approaches to implementing LIBOR fallback language have emerged – the amendment approach and the hardwired approach. The ARRC's syndicated loans consultation and bilateral loans consultation are similar and each provide for both a hardwired approach via a replacement rate waterfall and an amendment approach. The waterfall approach for each is essentially the same in the first two steps: Step 1: Term SOFR or if not available, then interpolated SOFR; and Step 2: Compounded SOFR. However, while the waterfall for bilateral loans in Step 3 reverts to an amendment approach to select a replacement rate in the event that a replacement rate cannot be determined in the first two steps in the waterfall, the waterfall for syndicated loans includes an additional step of overnight SOFR, before defaulting to an amendment approach.

Similarly, the waterfall for the replacement benchmark spread (adjustment) also includes a third option for bilateral loans. For each, in the first instance the spread adjustment is determined or calculated as selected, endorsed or recommended by the relevant government body, and if not available, then the spread adjustment is determined in accordance with the ISDA method. If a replacement reference rate is selected by the lender in the case of a bilateral loan, then the spread adjustment is selected by the lender as well.

The differences do not end there. Given the two products differ, their proposed amendment approaches differ as well to account for those differences. While the triggers, replacement reference rate and replacement benchmark spread adjustment for both are essentially the same, the mechanism to amend the credit agreement, naturally differs. For each, the trigger is a benchmark discontinuance event or a determination by the lender/required lenders (or the loan agent in the case of syndicated loans) that new or amended loans are incorporating a new benchmark interest rate to replace LIBOR. The replacement reference rate for each is either an alternate benchmark rate agreed between the agent and the borrower, in the case of syndicated loans, or between the borrower and the lender (or as agreed in an amendment), in the case of bilateral loans. The amendment mechanism for syndicated loans requires negative consent of required lenders for a benchmark discontinuance event and the affirmative consent of required lenders if the loan agent or required lenders determine that new or amended loans are incorporating a new benchmark. Bilateral loans differ in that for each trigger an amendment delivered by the lenders to the borrower (which may be subject to negative consent by the borrower) is the mechanism.

The Loan Syndications and Trading Association ("LSTA"), an active member of the ARRC, is chair of the ARRC's Business Loans Working Group which is focused on solutions for the LIBOR transition for syndicated and bilateral loans, and is a member of the ARRC's Securitization Working Group, representing the interest of collateralised loan obligation transactions ("CLOs"), and has published many advisories, articles and guidance on the LIBOR transition. As the LSTA points out, the amendment approach is a good preliminary solution for the syndicated loan market, given the ease and frequency with which loans are amended over their lifespan. Such approach provides the added benefit of not needing to rely on terms which do not yet exist and preserves the ability to leave the replacement rates and spreads to be selected in the future when more information on the options is available.[3] The downside, as the LSTA notes, is the possibility of disruption in the loan market in the future when such amendments are needed, and the fact that the amendment approach can be impacted by market cycles.

The LSTA also rightly points out that synching between products, particularly CLOs and syndicated loans, is necessary given that CLOs hold more than $580 billion of syndicated loans.[4] Of particular concern is basis risk which may be introduced if the loans held by a CLO utilise or flip to SOFR before LIBOR is discontinued, such that the CLOs' assets are tied to SOFR while its liabilities are tied to LIBOR. Although unlikely, it is also possible that the loan benchmark and CLO benchmark may differ in the event they follow their respective benchmark waterfalls and land at different replacement rates. It is something market participants are encouraged to consider.

Paced Transition Plan

In addition to the proposed alternatives to LIBOR published in each of its consultations, the ARRC also proposed a paced transition plan from LIBOR to SOFR, outlining milestones to be reached between now and 2021 to ensure a smooth transition.[5] As a first step, the ARRC's paced transition plan begins with a focus in 2018 and 2019 on creating a baseline level of liquidity for derivatives contracts referencing SOFR. The second step, targeted during 2019, is to further increase familiarity and understanding of SOFR over longer terms with increased trading activity in futures and overnight index swaps, followed in 2020 by central counterparty clearing houses offering members the choice of clearing swap contracts using SOFR. Each of the foregoing steps are in preparation for 2021's roll-out and establishment of SOFR term rates.

Legacy Transactions

Despite all of the proposals emerging from the ARRC and various industry groups, legacy transactions will remain a challenge. A paced transition plan to move new transactions from a LIBOR-based benchmark to a SOFR-based benchmark can be considered, negotiated and codified in new deals, but what about existing deals? For deals pegged to LIBOR with no defined alternative reference rate specified in the contracts, how are parties to proceed when LIBOR is no longer available? It seems an amendment approach, which would likely involve unanimous investor consent, may be the only option, but that may prove administratively challenging while also a substantial burden on the market if an urgent need to transition strikes all at once. In addition, imposition of the determination of a move to SOFR on any particular transaction party, such as a loan agent or trustee, is most likely not suggested by legacy transaction documentation and is likely not an acceptable approach for such transaction parties from a risk allocation perspective. How the proposed approaches to new transactions across products and asset classes are accepted and implemented may provide some guidance to parties of legacy transactions regarding which alternative benchmarks are available and best suited to their needs. Once a market consensus is reached, amendments may be entered into prospectively to address the almost certain cessation of LIBOR. It remains to be seen how legacy transactions will be addressed, but in the meantime, market participants must remain vigilant and informed and be prepared to act prior to a Benchmark Discontinuation Event with respect to legacy transactions.

Conclusion

Despite all of the developments and progress in moving the market forward toward an orderly transition away from LIBOR as 2021 approaches, the amount of work which remains to be undertaken by market participants in the transition period could be vast and should not be underestimated. Mechanisms for closing out legacy contracts will need to be addressed in order to meet the demands of market participants who anticipated pre-determined and forward-looking floating rate payment structures. Market participants should monitor the loan market for the adoption of alternative index rates, review safeguards and amendment procedures in agreements while continuing to review how the discontinuance of LIBOR impacts existing loan agreements and other transaction-related documentation.

Endnotes

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Chapter 26

Developments in the Syndicated Term Loan Market: Will Historical Distinctions from the High-Yield Bond Market Be Restored?


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Introduction

Traditionally, syndicated term loans that have been originated in the bank loan market have contained certain protective terms and provisions that could be distinguished from comparable terms and provisions included in debt securities issued in the capital markets (particularly the high-yield bond market). Over the past decade, and most significantly during the post-economic crisis period beginning in 2011, the protective terms and provisions included in documentation evidencing transactions in the institutional term loan market (or so-called term loan B market) have begun to resemble and, in some cases mimic, comparable terms and provisions traditionally found in high-yield bonds. The consequences of this convergence have begun to appear, resulting in heightened attention of term loan lenders being focused on this trend. Although it remains to be seen, this focus (and the consideration being paid to the resulting consequences) may signal an initial step in the reversal of this trend.

In this article, we will:

- provide an overview of the historical differences between the syndicated term loan market and the high yield bond market;
- discuss ways in which these two markets have begun to converge;
- highlight some of the recent developments and implications for traditional bank lenders arising from the convergence; and
- consider why these developments may ultimately result in the restoration of some of the historical distinctions between the syndicated term loan market and the high-yield bond market.

Historical Differences Between the Term Loan Market and the High-Yield Bond Market

Historically, syndicated loan agreements have contained covenant packages that were generally more restrictive than the covenant packages contained in the documentation governing high yield bond issuances. One could consider this distinction to be attributed to, among other things:

- *Investor Base*. The typical makeup of the investor base for each product has historically differed. Syndicated term loans have traditionally been funded by bank lenders whereas high-yield bonds have traditionally been arranged by a lead underwriter and purchased and funded by a diverse and widespread class of financial institutions.
- *Arranger Incentives*. The lead arranger or arrangers for a syndicated term loan facility historically retained material hold positions in the term loans they structured and arranged, creating a built-in incentive to negotiate robust credit protections. Underwriters in a bond issuance have historically been less likely to maintain a material position in an issuance and thus more apt to accept credit protections that would allow issuers greater freedom to conduct their business operations (so long as this freedom would not be expected to jeopardize a successful marketing/syndication process).
- *Tenor*. Syndicated term loans often have a shorter tenor than high-yield bonds. For debt products with longer tenors, borrowers often require flexibility to conduct their operations to reduce the need for unforeseen amendments and waivers (which can be costly and time consuming). For shorter tenors, borrowers are often more willing to agree to tighter business restrictions.

These characteristics play a significant role in explaining how the credit protections in syndicated term loans have developed and historically differed from those in the high yield bond market.

Changes to the Term Loan Market Resulting in Convergence

Changes to certain key defining characteristics of syndicated term loans as discussed above have spurred the adoption of changes to the underlying protective terms and provisions which were premised on these characteristics. As described in greater detail below, these changes help to explain the reason why the syndicated term loan market has begun to resemble the high yield bond market in certain fundamental ways:

- *Investor Base*. Alternative lenders (most often institutional non-bank investors) have increased their participation in the syndicated term loan market. As these alternative lenders have increased their participation in the term loan market, the risk appetite of the market necessarily changed and, as one might expect, moved closer to what these market participants were comfortable and familiar with – namely the high-yield bond market.
- *Arranger Incentives*. It has become less common for arrangers of syndicated term loans to maintain a significant hold position in the underlying term loans they arrange for the life of a facility. Rather, they have begun to arrange and structure with similar expectations as underwriters of bond issuances (which is with an anticipation of selling their position down). As the possibility that an arranger of term loans will not maintain their position increases, their negotiating incentives can change, focusing on obtaining terms and provisions sufficient to achieve a successfully syndication to institutional investors (which, as noted above, are now more prevalent in the term loan market and comfortable with the more lenient terms of the high-yield bond market).

- *Tenor*. Although shorter tenors could result in more stringent covenant packages traditionally, as the investor base and arranger incentives shifted, tenor has become less of a distinguishing factor.
- Examples of how these trends have manifested themselves in term loan documentation are varied. Generally, however, term loan documentation has begun to mimic high yield bond terms by (i) defining the composition of a borrower subsidiary group to whom covenants and events of default will apply, (ii) allowing the borrower greater access to excess cash flow and (iii) adopting more lenient covenants (including financial covenants), mandatory prepayment and event of default provisions, as discussed in greater detail below.
- *Restricted Subsidiaries*. The covenants and events of default in syndicated term loan agreements have historically applied to the borrower and all of its subsidiaries, whereas bond documentation would typically limit the applicability of covenants and events of default to the borrower and a limited subset of the borrower's subsidiaries that have been specifically identified, known as "restricted subsidiaries." Increasingly in the syndicated term loan market, the "restricted subsidiary" concept for covenants and events of defaults have been used in the governing loan documents.
- *Builder Baskets and Excess Cash Flow*. Bond documentation typically provided more flexibility for borrowers to allocate their excess cash flow through a concept known as "builder" baskets. Historically, "builder" baskets included in term loans were based on a percentage of excess cash flow that was not required to prepay the term loans. However, term loans have been adopting the bond market "builder" basket concept, which is keyed to a percentage of net income. Furthermore, the conditions that must be met in order to use the excess cash flow have also become more favourable to the borrower. For instance, replacing the absence of any default as a condition precedent to distributions with the absence of a bankruptcy or payment event of default.
- *Covenant-Lite*. Covenant-lite refers to the reduction or absence of financial maintenance covenants and inclusion of looser incurrence-based negative covenants. Covenant-lite provisions have historically been customary for bond documentation but have become increasingly prevalent in the term loan market. Covenant-lite loans require the borrower to take affirmative action before the covenants are tested. This approach allows borrowers to control triggering the testing of the applicable covenants. For example, restrictions on incurrence of debt, making acquisitions, paying dividends and repaying junior debt may only be restricted to the extent the borrower can't comply with a test before and after giving effect to the contemplated action. Borrowers cite the costs of complying with financial maintenance covenants as well as the unpredictability of certain events and/or the normal up and down of cash flows throughout a year which may affect compliance for a limited time but still result in a technical default. Despite the advantages to borrowers with covenant-lite loans, lenders lose an important early warning sign of deteriorating credit. The loss of this early warning sign results in the delay of a lender's rights to exercise remedies and negotiate with the borrower ahead of other creditors from what they would have had if historical financial maintenance covenants were employed.
- *Mandatory Prepayment*. Term loans have begun to adopt an approach to mandatory prepayments common in bonds – namely triggering an *offer* to prepay (which can be accepted or rejected by the lender) upon the occurrence of certain events as opposed to a *requirement* to prepay.
- *Looser Affirmative Covenants and Events of Default Generally.* Certain loan agreements have gone so far as to incorporate events of defaults and affirmative covenants similar to those found in bond documentation. For example, cure period for events of default may be longer (60 days for covenant default *versus* 30 days); cross-default events of default may be limited to cross-acceleration and cross-payment default; and reporting obligations may also be loosened.

Implications for Lenders and Recent Developments

This trend of convergence may limit many of the rights and protections that term lenders have historically enjoyed, virtually erasing the boundaries between term lenders and bondholders. Term lenders, in adopting these bond-like terms, effectively forego historical early warning signs and the opportunity to negotiate with the borrower ahead of other creditors in a default scenario, and may cause term lenders to face unanticipated risks and difficulties in restructuring loans.

Furthermore, lenders may find themselves in unintended situations where a borrower creatively uses increased flexibility in the covenant-lite structure to undertake actions that are detrimental to the lenders' interest. One such example occurred when J. Crew moved certain key assets into unrestricted subsidiaries and out of the lenders' expected collateral package. In this case, J. Crew reportedly used provisions in its loan documents that govern permitted investments in order to transfer the intellectual property behind its brand name into a newly-created unrestricted subsidiary, outside the reach of its term loan lenders. This new entity then issued debt to junior bondholders, secured by the transferred intellectual property. The J. Crew operating entities then entered into royalty-bearing license agreements, allowing them to continue to use the intellectual property they had originally owned while they remained beyond the reach of the term loan lenders.

The key covenant at play in the J. Crew transaction was the negative covenant on investments – this covenant is designed, similar to other key negative covenants, to prevent the borrower from making material changes to its business and assets. Investments by the borrower can potentially lead to losses and cash leakage from the borrower group, an outcome that this restriction is intended to prevent from happening. In the case of J. Crew, the investment covenant contained a variety of exceptions, including customary carve-outs and other negotiated baskets.

J. Crew was able to use a combination of certain exceptions it had in its investment covenant to exploit a loophole that was likely not anticipated. Specifically, J. Crew used a basket permitting investments by a Loan Party in a non-Loan Party, together with an exception permitting investments by non-Loan Party Restricted Subsidiaries. The end result was that J. Crew was able to transfer valuable trademarks to a foreign non-Loan Party Restricted Subsidiary, who then transferred these assets to a newly-formed Unrestricted Subsidiary. The exception allowing investments by non-Loan Party Restricted Subsidiaries on which the second transfer relied did not have any conditions other than a requirement that the investment in question had to be financed with the proceeds received by the Restricted Subsidiary from an investment in such Restricted Subsidiary. It's not entirely clear whether such condition was met, but the language was not drafted to refer to cash proceeds only, so J. Crew was able to take the view that the intellectual property transferred to the Restricted Subsidiary were proceeds received from an investment in a Restricted Subsidiary.

Certain lenders (holding about 12% of the term loan debt) who had not provided consent to the transfer and related transactions brought a cause of action based on the transfer transaction. J. Crew argued that the transaction was expressly permitted by the loan documents and ultimately successfully prevailed in the lawsuits. As a result, J. Crew was able to consummate a transaction that allowed it to move core assets out of the reach of its senior term lenders. It is possible that this outcome would have been prevented by the covenant protections historically included in term loan documentation. Therefore, the evolving covenant protections that have been observed as the term loan market and the bond market have converged likely played a contributing role in allowing for this outcome.

This case represents a practical example of the considerable impact that the trend in the syndicated term loan market to adopt bond-like provisions, can have. In the wake of this case and other similar cases that have been reported, lenders have been prompted to re-focus their attention and carefully consider the significant effects that the evolution of the term loan market may have on their rights and remedies as well as their ability to maintain and enforce the credit protective terms and provisions that have historically distinguished the syndicated term loan market from the high-yield bond market.

Conclusion

Although the trend toward adopting bond-like features in term loans has been profound and effectively conformed the term loan market norm in many respects to the high yield bond market norm, term loan lenders will need to be wary of the ultimate effects of covenant-lite structures in the name of providing operational flexibility to borrowers. As we have observed, this trend has the potential to gut the core protections that senior secured lenders have historically based their credit decisions on. With heightened attention now warranted, we are likely to see a trend toward revisiting certain covenant restrictions that have been loosened over the years, resulting in a new divergence of the two asset classes in some respects (although perhaps not to the same historical degree of difference). Lenders (and their counsel) must focus on the covenant packages included in credit documents and consider how creative borrowers may look to utilize the covenant freedom that has arisen as the syndicated term loan market has converged with the high yield bond market in ways that could be particularly detrimental to the interests of bank lenders.

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Green Finance

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1 Overview

Green financing is not new. There have been lenders and investors who have sought to target funds at enterprises and projects that exhibit environmentally friendly characteristics for some time; for example in relation to project financing where the Equator Principles and IFC's Sustainability Framework has been in existence for a number of years. This has been driven by the environmental concerns of those investors' and lenders' own stakeholders but also, in some cases, by recognition that enterprises and projects that are "green" may also be more financially viable.

What is new is the increased standardisation of the market for green finance and the volume of transactions identifying themselves as "green finance". This has been led, in large part, by the green bond market.

2 Green Bonds and Green Loans

Green bonds are debt capital market instruments. To date, they have tended to be medium-term and highly-rated instruments ranking *pari passu* with the issuer's conventional senior vanilla bonds.

Green bonds were first issued in 2007 by international development banks, such as the European Investment Bank and the World Bank's International Finance Corporation. The first corporate issues of green bonds occurred in 2013. In 2018, corporate issuers accounted for approximately 46% of green bond issuance, and sovereigns and development banks accounted for a large proportion of the remainder.[1]

Green loans are any type of loan instrument, such as term loans (including those structured on a corporate or project finance basis), RCFs and working capital facilities made available exclusively to finance or re-finance, in whole or in part, new and/or existing eligible Green Projects (on which see more below). According to Reuters, the volume of green loans syndicated in Europe is around €15bn in total. While green bonds and green loans are different financial products, their common aim is to finance sustainable development.

The green finance market and particularly the green bond market have experienced significant growth and development in recent years. This has been facilitated by the development of Green Bond Principles (**GBP**) by the International Capital Markets Association (**ICMA**) and the Climate Bond Initiative's (**CBI**) Climate Bond Standard, both discussed below.

According to the CBI, the green bond market doubled to almost US$83bn in 2016 (up from US$42.4bn in 2015). Issuance in 2018 is estimated to have reached US$167.3bn, with 204 new issuers entering the market. Moody's has estimated that green bond issuance in 2019 will grow by a further 20% to reach US$200bn. Therefore, while green bonds still account for a very small proportion of the total global bond market, the demand for and supply of green investments is increasing rapidly.

3 The Green Financing Gap

Following the entry into force of the Paris Climate Agreement (COP 21) in 2016, there has been increased international and governmental recognition of the need for decreased dependency on fossil fuels and that green finance is fundamental to the long-term growth of the global economy. According to the European Commission, Europe alone has to close a yearly investment gap of almost €180bn to achieve the EU's climate and energy targets by 2030. According to research by the China Council for International Cooperation on Environment and Development and the Ministry of Ecology and Environment, China requires an estimated US$433–577bn each year in green investments from 2015 to 2020 to realise its green policy goals.[2]

4 Current Market Standards

Although various market standards have been developed defining what constitutes a green bond or a green loan, these guidelines currently have no legislative or regulatory backing or authority.

The most widely recognised green financing principles are ICMA's GBP which seek to enhance transparency and integrity in the green bond market.

The GBP establish a voluntary high-level framework/methodology of market standards and guidelines based around the following four key components:

(a) **Use of proceeds**: proceeds must be used for green projects with clear environmental benefits, which must be specified in the transaction documentation.

(b) **Process for evaluation and selection**: the issuer must disclose its green objectives and the process for determining eligibility for green finance as well as its environmental risk management processes.

(c) **Management of proceeds**: the issuer must implement a formal tracking and attestation process linked to the issuer's green lending and investment operations to ensure ring-fencing of the proceeds.

(d) **Reporting**: the issuer must maintain up-to-date information on the use of proceeds and the GBP recommend reporting against qualitative and quantitative performance indicators.

The GBP recommend that issuers appoint an external review provider to confirm the alignment of their bond or bond programme with the four core components of the GBP outlined above, and that external reviews are made public in a consistent format alongside details of the scope of the review conducted. The GBP acknowledges that there are several levels and types of review that can be provided to the market, which can be broadly grouped as follows:

(a) **Second Party Opinion**: an institution with environmental expertise that is independent from the issuer may issue a Second Party Opinion.

(b) **Verification**: an issuer can obtain independent verification against a designated set of criteria, typically pertaining to business processes and/or environmental criteria.

(c) **Certification**: an issuer can have its Green Bond or associated Green Bond framework or Use of Proceeds certified against a recognised external green standard or label.

(d) **Green Bond Scoring/Rating**: an issuer can have its Green Bond, associated Green Bond framework or a key feature such as Use of Proceeds evaluated or assessed by qualified third parties, such as specialised research providers or rating agencies, according to an established scoring/rating methodology.

The GBP set out five high-level environmental objectives (climate change mitigation, climate change adaptation, natural resource conservation, biodiversity conservation, and pollution prevention and control) and a non-exhaustive definition of Green Projects designed to meet those objectives, which recognises the following broad categories of eligibility for Green Projects:

(a) renewable energy (including production, transmission, appliances and products);

(b) energy efficiency (such as in new and refurbished buildings, energy storage, district heating, smart grids, appliances and products);

(c) pollution prevention and control (including reduction of air emissions, greenhouse gas control, soil remediation, waste prevention, waste reduction, waste recycling and energy/emission-efficient waste to energy);

(d) environmentally sustainable management of living natural resources and land use (including environmentally sustainable agriculture; environmentally sustainable animal husbandry; climate smart farm inputs such as biological crop protection or drip-irrigation; environmentally sustainable fishery and aquaculture; environmentally sustainable forestry, including afforestation or reforestation, and preservation or restoration of natural landscapes);

(e) terrestrial and aquatic biodiversity conservation (including the protection of coastal, marine and watershed environments);

(f) clean transportation (such as electric, hybrid, public, rail, non-motorised, multi-modal transportation, infrastructure for clean energy vehicles and reduction of harmful emissions);

(g) sustainable water and wastewater management (including sustainable infrastructure for clean and/or drinking water, wastewater treatment, sustainable urban drainage systems and river training and other forms of flooding mitigation);

(h) climate change adaptation (including information support systems, such as climate observation and early warning systems);

(i) eco-efficient and/or circular economy adapted products, production technologies and processes (such as development and introduction of environmentally sustainable products, with an eco-label or environmental certification, resource-efficient packaging and distribution); and

(j) green buildings which meet regional, national or internationally recognised standards or certifications.

Green Projects can also encompass other related and supporting expenditures such as R&D and may relate to more than one of the above categories and/or environmental objectives.

There is no requirement in the GBP that Green Projects offer "additionality" in the real world, whether direct or indirect.

The GBP draw a distinction between their environmental objectives and the "Green Projects" designed to meet them, thereby allowing additional project types to be included in the future, provided they meet the stated environmental objectives. The GBP also acknowledge the existence of various international and national initiatives to develop common definitions, standards and taxonomies, such as that contained in the European Commission's sustainable finance proposals, and encourages issuers to use these to develop their own robust practices.

Whilst the GBP recognise the benefits of a common taxonomy for green lending, which supports market integrity through consistency of standards and reporting, the GBP do not seek to be the final arbiter of what is "green". This approach makes the GBP easier for issuers to adopt, whilst leaving the final determination of what is "green" to emerge in light of investor consensus and the third party external review process, certification or second opinion process so that the GDP can adapt over time to reflect the impact of any changing market consensus over what is "green".

The GBP have typically been updated annually since their introduction in 2014 to reflect the development and growth of the global green bond market and were most recently updated in June 2018 (along with ICMA's Social Bond Principles and Sustainability Bond Guidelines). The most recent revisions to the GBP expanded the range of environmental objectives and included more detailed definitions of external review services and a greater emphasis on timely reporting of material developments by issuers to investors.

The CBI has also developed its own certification that is available for assets and projects that meet the requirements of the Climate Bonds Standard. Certification is currently available for assets and projects in the solar, wind, geothermal, marine renewables (including offshore wind and solar, wave and tidal), water infrastructure and low carbon transport and buildings sectors. The Climate Bond Standard allows certification of a bond prior to its issuance, enabling the issuer to use the Climate Bond Certification mark in marketing efforts and investor roadshows. The Climate Bonds Standard is aligned with ICMA's GBP. It is worth noting that the list of eligible debt instruments that can be certified under the latest version of the Climate Bond Standard includes loans and that the Climate Bond Standard requires (rather than recommends) issuers to use external reviewers to confirm alignment with the key features of the Climate Bond Standard.

In addition, some countries, such as China, India and France have developed national green bond principles which are largely aligned with the GBP and the Climate Bond Standard. In December 2017, the People's Bank of China and China Securities Regulatory Commission jointly released new guidelines for green bond verifiers and verification activities in China. These guidelines are broadly modelled on the Climate Bond Standard and introduce regulatory requirements for verifiers, which essentially take the form of a verifier licensing scheme. This is notable in being the first time a government has introduced regulatory oversight for verifiers. It recognises that while voluntary standards and third party verification schemes have served the industry well thus far, in a rapidly expanding market, there is a greater need for regulatory supervision.[3]

In relation to the loan market, the Loan Market Association published its Green Loan Principles (**LMA GLP**) on 21 March 2018. The LMA GLP build on and refer to ICMA's GBP with a view to promoting the development and integrity of the green loan product and consistency across the financial markets. They incorporate the four GBP core components and the approach to defining Green Projects outlined above (but do not reference the GBP's environmental objectives).

The LMA GLP recommend that an external review of the green loan is carried out where appropriate and expand on the types of external review that could be undertaken to include self-certification by a borrower which has demonstrated or developed the internal expertise to confirm alignment of the green loan with the key features of the LMA GLP, given that the loan market is traditionally a relationship-driven market and therefore lenders are likely to have a broad working knowledge of the borrower and its activities. While the use of a third party consultant and/or an external assessment standard promotes independence and consistency, the LMA GLP implicitly recognise that this may not be suitable for all loans; for example, lower value loans where the cost of a third party external review may be disproportionate to the cost of borrowing.

In December 2018, the LMA together with the U.S. Loan Syndications and Trading Association (**LSTA**) and the Asia Pacific Loan Market Association (**APLMA**) published an extended iteration of the LMA GLP, providing a more in-depth explanation as to how the GLP can be applied to revolving credit facilities (**RCFs**) whilst maintaining the integrity of the green loan product. The guidance recognises that it may not be easy to identify the use of proceeds in an RCF, and advises that the parties to any proposed green loan taking the form of an RCF will need to determine how best to evidence the flow of funds to an agreed-upon sustainable objective when applying the LMA GLP to such a loan. For example, an RCF may include a specific green tranche or, if not possible, a borrower may seek to report to its lenders on the use of any RCF borrowing and/or identify green assets supported by the RCF. However, the LMA GLP guidance is clear that RCFs for general corporate purposes should not be categorised as "green" without satisfying the four components in the GLP.[4]

5 The Link to ESG

Although it is usual practice for most loan documentation to provide for a borrower to comply with all relevant environmental and social legal requirements as part of its obligation to comply with all general legal requirements, this does not extend to cover wider environmental, social or governance (**ESG**) targets, such as those contained in voluntary guidelines, best practice and recommendations.

Currently the ICMA GBP and the LMA GLP do not contemplate the inclusion of wider ESG considerations. However, the bilateral nature of loans means that the terms of a loan can be tailored to accommodate the circumstances and desire of the parties as regards compliance with broader ESG targets alongside "green" use of proceeds.

The ability to adapt the terms of loan documentation to accommodate, incentivise and penalise ESG factors make them well suited to the promotion of sustainable behaviour. In particular, ESG factors are now being used to inform the pricing of a loan. Borrowers can be incentivised by way of a margin ratchet based on certain ESG key performance indicators or criteria: if the criteria are met then the borrower gets the benefit of a cheaper margin and if performance falls below a baseline, the borrower can be subject to a margin penalty. These incentive/penalty mechanics are particularly attractive to borrowers who wish to integrate elements of their corporate social responsibility policies into their financing strategy.

6 Greater Standardisation

There are now a significant number of green finance initiatives at an international and European level in addition to the national and market initiatives (a few of which are mentioned above); these include:

(a) the work of the G20 Green Finance Study Group which is currently looking at ways to mobilise private capital for green investment, specifically focusing on banking, the bond markets, and institutional investors;

(b) the Financial Stability Board's Task Force recommendations on climate-related financial disclosures;

(c) the collaboration of the World Bank and other larger multilateral development banks on common approaches to monitor and track climate finance flows; and

(d) the ISO's guidelines on climate finance and the first internationally accepted certification of climate performance.

While the green bond market is considered to be fairly advanced in terms of the development of definitions and tracking as a consequence of the development of ICMA's GBP, it is apparent that action is needed at an international level to develop standardised policies for the regulation and evaluation of infrastructure for green bonds and other green financial instruments in order to make the market more readily accessible to a wider range of investors.

In the last couple of years, there has been a push from the world's largest investors/lenders, central banks, regulators and market organisations for new frameworks setting out market terms and standards for green finance to be developed.

In December 2018, Bloomberg announced the formation of the U.S. Alliance for Sustainable Finance (**USASF**) to drive investment in clean energy and climate resilience projects across the U.S. The formation of the USASF by 15 major financial institutions is aimed at providing the resources and expertise to identify and streamline existing climate-finance initiatives, encouraging greater transparency across climate-related financial risks and opportunities and, ultimately, driving more capital to sustainable investments. The USASF has also committed to develop and participate in national and international partnerships to increase the impact of green and sustainable finance.[5]

In May 2018, the European Commission (**Commission**) published three proposals as a follow-up to its action plan on financing sustainable growth.

The Commission's proposals support the goals of the EU's Capital Markets Union to connect finance with the needs of the European economy to the benefit of the planet and our society and the EU's Action Plan on sustainable finance published by the Commission in March 2018, which provides a roadmap for the EU's commitment to meet the goals set out in the 2016 Paris Agreement and the UN's 2030 Agenda for Sustainable Development.

The Commission's combined package of proposals aims to facilitate investment in sustainable projects and assets across the EU and to put ESG considerations at the heart of the financial sector to create a greener and more resilient system by introducing:

(a) a unified EU classification system (taxonomy) for environmentally sustainable economic activities which can then be embedded into different areas of EU law and will facilitate the development of sustainable standards, labels and benchmarks;

(b) rules clarifying how institutional investors (asset managers, insurance companies, pension funds or investment advisors) should integrate ESG factors into their investment decision-making, risk processes and advisory processes, and transparency relating to financial products which target sustainable investments; and

(c) a new category of benchmarks, comprising the low-carbon benchmark or "decarbonised" version of standard indices and positive-carbon impact benchmarks which will help investors compare the carbon footprint of their investments.

During the course of 2019, the Commission is expected to adopt a delegated act on the content of the prospectus for green bond issuances, amend its non-binding guidelines on non-financial reporting and publish a study of sustainability ratings and research and a fitness check of EU legislation on public corporate reporting. As part of its Action Plan, the Commission also announced that it is considering whether investment in sustainable or green projects should be treated as less risky than carbon-contributing investments, such that sustainable financial products would have lower capital requirements.

The shift towards collective action on green finance and standardisation also extends to emerging markets. IFC's Sustainable Banking Network, an alliance of banking associations and financial sector regulatory agencies from emerging markets, has also taken steps to advance sustainable finance in line with international good practice. In October 2018, the Sustainable Banking Network, in collaboration with the CBI and the IFC issued its first Green Bond Report, containing a practical Green Bond Market Development Toolkit for emerging markets, including common objectives, a self-assessment and planning matrix and a roadmap with common milestones.[6]

7 Beyond "Use of Proceeds"

As noted above, a core component of the ICMA GBP and LMA GLP is the requirement to use the proceeds of the loan or bond instrument for Green Projects. As the green finance market evolves and a common green finance taxonomy emerges, it seems likely that green finance documentation will move beyond a simple "use of proceeds" requirement towards applying a tailored set of specific contractual consequences, such as lock-up, acceleration or a margin ratchet, in the event of a borrower/issuer failure to meet or maintain identified green eligibility criteria.

It also seems likely that there will be increasing convergence between the dedicated market for green finance and the broader markets for ESG and other social, sustainability, climate and impact finance. According to the CBI, the labelled bond market is now rapidly expanding beyond "green" bonds and a key driver of this is the emergence of SDG bonds, as issuers and investors are starting to adopt policies and strategies linked to the UN's 17 Sustainable Development Goals. In 2018, broader sustainability bond issuance totalled US$21bn, representing a 114% growth compared to 2017. Likewise, social bond issuance also increased in 2018 to US$14.2bn, a 37% year-on-year growth.

An LMA, LSTA and APLMA working party has announced that it will be seeking to produce a set of principles in 2019 that apply to sustainability improvement loans, being those loans that incentivise a borrower to achieve predetermined sustainability performance targets. This is a welcome step towards standardisation in the wider sustainable finance market.

By way of an example reflecting these trends, in November 2018, Hogan Lovells advised Électricité de France S.A (**EDF**), the French majority-owned state electric utility company, on its successful syndication of a €4 billion ESG-indexed RCF. The RCF introduced a sustainability pricing mechanism indexing the margin to three of the group's ESG criteria: direct CO_2 emissions, customer use of online consumption monitoring tools (as a proxy for getting residential customers actively engaged in their energy consumption) and the electrification of EDF's vehicle fleet.

In the project finance space, some development banks are also beginning to introduce margin reduction plans, which allow a portion of the margin to be set aside in a project bank account and applied to doing good things in the community, the application of which is then monitored by the project lenders' technical adviser.

There are also proposals to attach specific regulatory or fiscal incentives to green finance, such as allowing green loans/bonds to be eligible for use as collateral in central bank operations, implementing preferential risk-weightings for green assets and reducing liquidity constraints for medium-/long-term green funding. On the issue of regulatory incentives, it is not axiomatic that every green loan or green bond involves lower risk for the lender, so care will be needed to calibrate any such incentives, so that they are only applied to forms of green finance where there is clear evidence of a lower lending risk and enhanced repayment profiles (energy efficiency enhancements in properties are thought to be one such example). Otherwise, these incentives could compromise the key objective of maintaining capital buffers, which is to safeguard the system of sound and solvent banks.

There remains a great deal of variation around the reporting and scoring of performance for margin ratchet purposes and the role of self-certification in green loans globally. While, in theory, the LMA GLP permits borrowers to self-certify compliance with green lending criteria, this evaluation is generally undertaken by an external reviewer, for example an ESG consultant. In order to build confidence in the role of the external review in the green finance context, clearer guidance is needed on when an external review is required and the appropriate standards to be applied.

There is clear growth and momentum in the green finance market which shows no sign of abating. This sits alongside the broader focus on corporate business integrity. There remains a risk of being seen to "greenwash" an investment, and borrowers and lenders alike should continue to take care to ensure that their activities in the space are genuine and capable of being evidenced to the market and their stakeholders.

Endnotes

1. A copy of the *Climate Bonds Initiative: 2018 Green Bond Market Summary* is available at https://www.climatebonds.net/files/files/2018%20green%20bond%20market%20highlights.pdf.
2. China's Green Finance Strategy: much achieved, further to go (published on 24 October 2018) http://www.lse.ac.uk/GranthamInstitute/news/chinas-green-finance-strategy-much-achieved-further-to-go/.
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6. A copy of the report can be found at https://www.ifc.org/wps/wcm/connect/55e5e479-b2a8-41a6-9931-93306369b529/SBN+Creating+Green+Bond+Markets+Report+2018.pdf?MOD=AJPERES.

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Andrew helps clients to future-proof their businesses and identifies risks and opportunities in the green finance space, having worked on financings by issuers across a wide spectrum of credit quality, geography and sector.

Andrew has advised clients such as Carbon Trust and EDF on their establishments of Green bonds and other climate bond and renewable energy projects and has also provided advice to the LSTA regarding the Green Loan Principles.

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U.S. Tax Reform and Effects on Cross-Border Financing

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Introduction

On December 22, 2017, the United States enacted perhaps its most significant tax reform ever, commonly referred to as the Tax Cuts and Jobs Act ("**TCJA**"). This reform fundamentally changed nearly every aspect of business tax planning, including significant changes to cross-border financing. Most, if not all, of the business tax features of the TCJA add complexity to the Internal Revenue Code (the "**Code**")[1] and the process of issuing and finalizing regulatory guidance covering the most significant features of the TCJA is not expected to be complete until June 22, 2019.[2] Even still, to paraphrase Winston Churchill, this will not be the end, or even the beginning of the end, but will rather perhaps mark the end of the beginning. This is because, while the Internal Revenue Service ("**IRS**") and U.S. Department of Treasury ("**Treasury**") have issued thousands of pages of proposed regulations since the enactment of the TCJA, there have been perhaps an even greater number of pages written by those in the business community and their tax advisors expressing concerns and posing questions.[3] It is simply not possible that the IRS and Treasury, in their effort to finalize the regulations by June 2019, will be able to address all the issues and please everyone. Some of the TCJA-related regulations that have already been finalized are currently being attacked in U.S. courts. Further, the IRS and Treasury will likely spend years and years issuing additional guidance.

This somber introduction is a warning that what follows in this chapter will necessarily only cover the basics of how the TCJA affects cross-border financing, helping the reader understand what has changed and highlighting areas of concern. The following will not go through a labyrinth of "if, then" scenarios and speculation. This chapter's online version will be updated in the Fall of 2019 and so the reader is encouraged to continue checking in to receive updated information as these rules evolve.

A. Tax Cuts & Jobs Act (TCJA) Overview

Prior to the TCJA, the U.S. business tax system was essentially a "worldwide" system with a high corporate tax rate (35%). The TCJA moved the U.S. business tax system towards a "territorial" system and reduced the corporate tax rate to 21%. Very generally, a worldwide tax system taxes the resident taxpayer on income wherever it is earned around the globe and attempts to prevent double taxation via income tax treaties with other countries and foreign tax credits. In contrast, a territorial system only taxes a resident taxpayer on income earned in its country of residence. The U.S. system, prior to the TCJA, was not a "pure" worldwide tax system. For example, prior to the TCJA, the U.S. system deferred taxation of non-passive foreign-sourced income until such earnings and profits were repatriated to the U.S., at which time they were subject to tax. A "pure" worldwide system would have taxed these earnings and profits when earned.

Interpreting and complying with pure forms of worldwide or territorial tax systems are far less complicated, however, for various policy (encouraging behavior) and fiscal (raising revenue) reasons; essentially most of the major developed countries do not have a "pure" tax system.[4]

The U.S. is no exception. The reduction in the corporate tax rate (to 21%) and other taxpayer-favorable rules meant that the move toward a territorial system would be limited; what I will refer to as a "quasi-territorial system." As will be detailed below, this means that only certain U.S. taxpayers get to exclude foreign-sourced earnings and profits from the U.S. tax net, and even those taxpayers only get the exemption up to a certain amount.

Even limiting territoriality did not raise enough money. For this reason, and because Congress feared other taxing jurisdictions would tax too much of U.S. company earnings and profits (or put another way, U.S. companies would move their earnings and profits to low-tax jurisdictions), the TCJA introduced a host of other changes to existing rules (e.g., interest deductibility) and crafted entirely new taxes (e.g., the global intangible low-taxed income ("**GILTI**")). At the same time, the TCJA picks winners and losers in often arbitrary ways and this is another source of complexity.

Many of these changes affect international financing transactions and those aspects of the TCJA will be a focus of this chapter. Before we get into the specific rules that affect lending practices, it is worth providing a very brief overview of some of the TCJA changes that will not be discussed in any detail below, but which may have an impact on credit evaluation. First, as mentioned above, there has been a drastic reduction in the corporate tax rate, from 35% to 21%. This new 21% corporate rate should be compared to the maximum individual rate, which was modestly reduced from 39.6% to 37%. The gap between these rates should be instructive when considering whether to set up the lending structure as a corporation or a passthrough (partnership or trust). The standard combined federal and state rates for corporations, which used to be in the 38–40% range, are now being estimated as 25–28%, and the individual rate, important for tax distribution provisions (to avoid or minimize the pain from phantom income) is around 42–45%. This rate will vary now considerably based on the new TCJA rule that limits the amount of state and local tax ("**SALT**") deductions an individual can take to offset federal taxable income. Individual taxpayers in California, New York, Connecticut, Illinois and other high tax states are significantly affected by this change. These rate changes are particularly important to cross-border lending arrangements involving partnerships (or some other passthrough entity). This is because often in these deals the borrower (the partnership) is allowed to make tax distributions to its partners so that the partners can have cash necessary to pay their taxes. As a practical matter, parties often approximate the necessary tax distribution amount based on using an entity-level tax. In other words, because partners are unique and could have vastly different effective tax rates, some agreements would approximate the tax burden by using the corporate rate (previously 35%). Prior to the TCJA, the rate difference between the individual (39.6%) and corporation (35%) was insignificant, and so this was an acceptable proxy. However, after the TCJA, this difference is significant (37% *versus* 21%). The credit parties will have to consider carefully these restricted payment covenants and exceptions for tax distributions.

Consideration should also be given to the one-time transition tax (Section 965) (15.5% on cash and liquid assets and 8% on other assets) and the eight-year payment plan of this tax when analyzing the credit risk of companies with international operations. While this tax applied in 2017, the interest-free eight-year payment instalment plan makes this tax important for years to come. This is because the payment obligation can be accelerated in certain circumstances. Therefore, Section 965 should be added to every deal due diligence list.

Such international companies will still be potentially subject to the old Subpart F rules (present tax on certain foreign-sourced income, regardless of repatriation), but now will also have to deal with GILTI and BEAT (as defined below). There is also a significant haircut to the value of net operating losses ("**NOLs**") and interest deductions (as detailed below). NOLs can now only offset up to 80% of taxable income, and for NOLs generated after 2017, there is no carry back. These new rules will likely have a negative impact on deferred tax attributes and future cash flows.

There is some good news, and that is that domestic companies that exploit intellectual property via sales to foreign parties may be eligible for a deduction under the new foreign derived intangible income ("**FDII**") rules that could reduce the tax rate on such income to as low as 13.125%. Also, for the next several years U.S. taxpayers are eligible for 100% expensing on the purchase and use of business assets, although this is just a timing benefit.

A general takeaway from the TCJA, as it relates to cross-border lending, is that the value of debt financing has been significantly diminished for U.S. taxpayers (in large part because of the 30% limit under new Section 163(j) and BEAT, detailed below). So, it is expected that interest deductions will be replaced with equity financing (or instruments with lower interest rates or no interest rates), financing that does not involve borrowing (such as sale-lease back transactions or financial products), and that there will be a reallocation of debt to non-U.S. subsidiaries. The use of hybrid instruments and hybrid entities will also likely diminish under the TCJA.

B. The Immediate Impact of Quasi-Territoriality on Lending Practices

The half-measured approach of the TCJA causes complexity which may be paralyzing. Perhaps the best example of this is the TCJA's application to cross-border collateral packages involving "controlled foreign corporations" or "CFCs" (defined below). Prior U.S. tax law made it anathema to run afoul of the Section 956 limitations on "CFC collateral" or a guaranty by a CFC, since violation of these rules would result in the "deemed repatriation" of foreign-sourced earnings and profits (in the amount of the loan), which could impose significant tax problems for a U.S. borrower.

Under prior U.S. tax law, in order to comply with Section 956, credit agreements limited pledges of CFC stock to 66⅔% (frequently 65%), prohibited CFCs from giving guarantees and direct collateral and included certain other restrictions. These Section 956 restrictions are ubiquitous in credit agreements involving U.S. borrowers with CFCs.

If the TCJA implemented "full territoriality," there would be no need for Section 956. Strangely, Congress appeared set to eliminate Section 956, but the final version of TCJA dropped this provision, perhaps because someone realized that "quasi-territoriality" still had a use for Section 956. At first blush, abolishing Section 956 made some sense, since treating a "deemed dividend" (under Section 956) differently from an actual dividend would appear to elevate form over substance and be unnecessary. The Treasury came to the rescue to clean up the mess by issuing proposed regulations to clarify that Section 956 was indeed turned off, in a manner that would apply narrowly to the conditions of "quasi-territoriality." In other words, if Section 245A would have allowed the actual dividend to be tax-free via the 100% dividends received deduction (a.k.a. the "participation exemption"), then the Section 956 deemed dividend would also be tax-free.[5]

As a practical matter, it seems unlikely that parties to a credit agreement will go through the drafting machinations to marry the credit provisions to the precise circumstances in which Section 956 will no longer be applicable, even though such circumstances may very well permit the lenders to take CFC collateral or a CFC guaranty without causing a 956 issue a majority of the time. Put another way, in order to fully allow for the Section 956 shut-off, the credit agreement would have to explain and administer situations in which Section 245A applies, which as we will see later in this chapter, can be highly complicated, especially in the case of hybridity.

Where does this leave parties to a credit agreement? The TCJA's move away from taxing some of the foreign-sourced earnings and profits of a CFC presented the question as to whether borrowers could now fully pledge CFC stock or have CFCs guarantee the U.S. borrower's obligations. The question does not lend itself to an easy answer, and consequently, taking full advantage of the benefits of the TCJA will require careful analysis, a theme that will repeat throughout this chapter. If the parties to a lending transaction choose to forego this effort, the cost would be the borrower's lost benefit to borrow against a greater collateral package, without a negative tax result. Borrowing against a larger collateral package could result, in theory, in the borrower obtaining a lower interest rate or a higher loan amount, because it would give the lender more security. Not uniquely, the Section 956 tax complexity leads to market inefficiencies. As stated above, it is unlikely, at least in the near term, that credit parties will revise the standard credit facilities to take full advantage of the Section 956 shut-off.

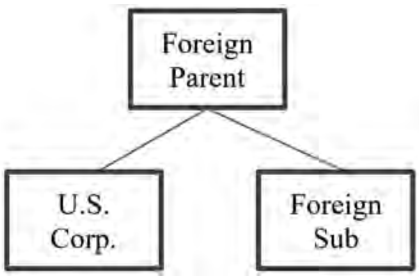
What is more likely is that borrowers may seek better deal terms by offering to have fewer or no Section 956 restrictions on collateral. This is likely because the TCJA's transition tax (Section 965) created a good deal of "previously taxed income" and cleared out significant foreign earnings and profits, and at the same time the introduction of GILTI, together with the Subpart F rules, means that more often U.S. corporate borrowers with CFCs will be paying actual dividends back to the U.S. and will not have to worry about the Section 956 deemed dividend rules at all. In other words, those U.S. corporate borrowers that really are not getting any benefit from deferral of U.S. taxes anymore (which should be a large number of companies), may seek to voluntarily remove the Section 956 restrictions from credit agreements in an attempt to get better deal terms. These borrowers should be careful in drafting these new provisions, to take into account exactly when Section 245A will and will not apply. As part of this, borrowers will need to consider holding periods, SALT[6] and anti-hybrid rules.

In a way, it will be unfortunate if standard credit agreement terms are not revised to account for the TCJA and regulatory changes to Section 956, since so many U.S. corporations will be dealing with this new TCJA reality. Moreover, the TCJA broadened the scope of Section 956 by expanding the definition of a CFC and "U.S. Shareholder." Importantly, this expansive definition will likely catch some companies off guard, so while those companies may have been assisted by a change to the standard terms of credit agreements, they will unfortunately need to do the due diligence to see if they are covered.

Pre-TCJA law only considered foreign corporations to be CFCs if 10% of the voting shares was held by a U.S. Shareholder, and for purposes of identifying a "U.S. Shareholder," one only considered voting shares. The TCJA changed these rules to provide that vote or value can result in both a person being a "U.S. Shareholder" and vote or value can also cause a foreign corporation to be treated as a CFC.

> *Example* – Under prior law, U.S. individuals A, B, C, D and E each owned 8% of the voting rights in, and 10% of the value of, ForCo, and a U.S. corporation (F) owned 30% of the value, but no voting rights. ForCo would not have been a CFC because none of A, B, C, D or E would be a "U.S. Shareholder" under the old rules, because the requisite amount of voting stock was not owned by any of these shareholders (only 30% is owned by F and it must be greater than 50% to trigger the CFC status). After the TCJA changes, all the shareholders would be "U.S. Shareholders," and in such case 80% of the vote or value ForCo would be owned by "U.S. Shareholders" (80% of value).

Further, TCJA repealed a rule that turned off downward attribution from a foreign corporation to a U.S. corporation. As a result, foreign corporations wholly owned by other foreign corporations may be CFCs if there is a U.S. corporation somewhere in the structure. The most simple structure best illustrates the problem.



Here, U.S. Corp is treated as owning all the shares of Foreign Sub via "downward attribution." As a result, Foreign Sub is a CFC. If Foreign Parent has any "U.S. Shareholders," those shareholders could be negatively affected under the Subpart F and GILTI rules. The TCJA change to allow for downward attribution was intended to address specific situations, such as inversion structures, but after enactment, the overly broad scope was criticized by taxpayers and the tax bar and as a result there is a chance that Section 958(b)(4) will be reintroduced in some other form.[7]

Critically important to the world of cross-border financing, existing credit facilities (or new credit facilities not taking into account these new CFC rules), may have required Foreign Sub to provide a guarantee, or have Foreign Parent pledge 100% of Foreign Sub stock. The result would be that Section 956 could be triggered. The implications of this will depend on the facts, but the only way to make sure that the expansion of the definition of "CFC" will not result in negative U.S. tax consequences from the credit agreement is to do the necessary due diligence by reviewing the structure chart of the organization and reviewing the capital structure and credit agreements. This review will likely require careful analysis of the "change in law" provisions of the credit agreement in order to determine whether the TCJA constitutes such a change that could allow some relief.

One severe example is a situation where a credit agreement has a provision requiring repatriation of monies of foreign subsidiaries if there are "no adverse tax consequences." This type of a carve-out from the Section 956 limitation on collateral/security may require repatriation from these types of foreign subsidiaries. Analysis of these types of provisions would not only be important in the ordinary course, but could be very important in the event that the borrower becomes distressed and bankruptcy priorities come into play.

To reiterate, while the proposed regulations provided relief to a U.S. shareholder who would otherwise qualify for Section 245A, to the extent that the U.S. shareholder does not qualify, such taxpayer would face a tax liability on the actual or deemed dividend. The general discussion above becomes very complicated if the U.S. borrower does not directly or indirectly own the foreign subsidiary offering credit support. Because the benefits of Section 245A are only granted to certain U.S. taxpayers (U.S. corporations), other taxpayers, such as individuals or partnerships, could suffer negative tax consequences if Section 956 is ignored.

As alluded to above, Section 245A also does not apply for dividends that are considered "hybrid dividends."[8] An example of a hybrid dividend is a dividend the payment of which would allow the payor a tax deduction. The purpose of Section 245A(e) is to prevent a "double benefit." Traditionally the great dichotomy between interest (debt) and dividend (equity) payments is that interest payments allow for a deduction for the payor, while dividends do not. To sustain this dichotomy requires that an "interest like deduction" for the payor should proscribe dividend treatment under Section 245A and the TCJA does this via Section 245A(e). This is important to credit parties because the rules governing the deductibility of the "dividend payment" will vary from jurisdiction to jurisdiction and when the lending transaction is one in which the lending party can change, or involve multiple lenders, such as syndicated deals or securitization transactions, monitoring this aspect of the rules, especially when laws change, will be challenging.

What is more certain is that popular hybrid instruments, and their concomitant structures, will no longer provide the benefits they did in the past. One such example is the Luxembourg structure involving a preferred equity certificate or "**PEC**." A PEC is debt for Luxembourg purposes and equity for U.S. purposes. Prior to the TCJA, a U.S. company could use PECs to capitalize a Luxembourg holding company, which holding company could then buy a European target (or a target in another treaty-friendly jurisdiction, perhaps). The U.S. company would not be currently taxed until there was a distribution on the PECs. This structure would have been supercharged under the TCJA, if it were not for the special rule that disallows the participation exemption for "hybrid dividends," which would include distributions made on PECs.[9] This is because, without this rule, the Luxembourg company could have made distributions that would have been, at least in part, tax-free in the U.S. However, with an anti-hybrid dividend rule, at best the PEC structure is disfavored relative to other structures under the TCJA.

A recurring theme of this chapter is that the TCJA requires a fresh look at organizational structures and the motivations behind them. Littered throughout the TCJA are attribution and aggregation rules that can present pitfalls and traps for the unwary. For example, there is a rule in the Section 163(j) proposed regulations that will cause a domestic (or foreign) partnership to be part of the "CFC group" under certain circumstances.[10] Identifying the entities to be evaluated as part of the TCJA is only the starting point, then one actually has to apply the rules, which as we will see in the next section are very complicated.

C. Limitations on the Deductibility of Interest – Sections 163(j), 59A and 267A

At the heart of tax considerations for any lending arrangement is the tax deductibility of interest payments. Thus, any rules limiting the borrower's ability to deduct interest are important. The deductibility of interest is generally what makes debt financing more favorable than equity financing (payment of dividends is not deductible by the payor). In this section we will cover the TCJA's impact on the deductibility of interest. This section is organized around the following questions: (i) "is the instrument a debt instrument?"; (ii) "is the interest payment deductible?"; and (iii) "if the interest deduction is allowed, are there any rules that decrease the value of the deduction?"

The first question is whether the instrument is a debt instrument. This is a natural place to begin, since if the instrument is recharacterized by the IRS as equity, no interest payment exists at all, but rather the payment would be treated as a dividend. The "debt versus equity" question came to a boiling point in 2016, when the Treasury issued regulations under Section 385 (the "**Section 385 Regulations**"). The TCJA did not change these not-so-new-anymore so-called "debt versus equity" regulations. Some speculated that after the TCJA there may be some easing of the Section 385 Regulations, and the Treasury has proposed removing the documentation rules,[11] but generally speaking the IRS has indicated that for the most part the complicated Section 385 Regulations still apply. As such we will not detail the Section 385 Regulations herein except to say that these rules are critical to the first question relevant to the deductibility of interest, since if the instrument is not debt, then there is no interest to deduct. To grossly oversimplify the analysis, the Section 385 Regulations require that the credit parties intend the instrument to be debt, document it as such (with terms typical to arm's-length lending) and behave as creditors-debtors.

The Section 385 Regulations share something in common with the old Section 163(j) limitations, since both considered the thinness of capital of the borrower. If the borrower was too thinly capitalized, then under the Section 385 Regulations the instrument could be characterized as equity. Under the old Section 163(j), the limitation on the deductibility of interest was essentially based on two things: (i) whether the foreign lender is related to the borrower; and (ii) whether the debt-to-equity ratio of the borrower is excessive (i.e., the thinness of capital). The new Section 163(j) limitations are fundamentally different and do not care about either of these two factors. They can apply regardless of whether the lender is a related party or a foreign party. Further, the only relevance of the thinness of capital is to the starting question of "do we have a debt instrument?" Once the instrument is established as debt under the Section 385 Regulations and relevant case law, then we begin the gauntlet of new rules that figure out whether the interest payment on the debt instrument is deductible and to what extent. When considering the extent of the tax benefit of the interest deduction, the U.S. taxpayer now needs to consider the base erosion anti-abuse tax ("**BEAT**") under Section 59A.

Assuming that the instrument is debt, the next step is to consider new Section 163(j). Although the new rule is effective for years beginning after December 31, 2017, the rules apply to debt issued prior to that date (i.e., there is no grandfathering rule for debt issued prior to the TCJA). The first thing to determine is whether the borrower qualifies for the small business exception, which applies to businesses with less than $25 million in gross receipts.[12] If this gross receipts threshold is exceeded, then, unlike the old Section 163(j), the new Section 163(j) applies regardless of whether the lender is a related-party or foreign, and it applies regardless of whether the borrower is a corporation or partnership and regardless of any debt-to-equity ratio.

The new Section 163(j) limits all business interest deductions to 30% of "adjusted taxable interest" ("**ATI**"), plus business interest income, plus "floor plan financing."[13] Thus, if the borrower has ATI of $100, business interest income of $10 and floor plan financing of $5, and business interest expense of $100, then only $45 of this interest would be allowed as a deduction ((30% × $100) + $10 + $5). The remaining $55 of interest can be carried forward indefinitely, but each year it must be processed through this formula, so absent an increase to ATI, such carryforward may not be useful.[14]

ATI is the taxable income of the borrower computed without regard to: (i) any item of gain, deduction, or loss which is not properly allocable to a trade or business; (ii) any business interest income or business interest deduction; (iii) the amount of an NOL; (iv) the amount of any deduction under Section 199A (i.e., the new TCJA partnership passthrough deduction); and (v) any deduction allowed for depreciation, amortization or depletion. This is similar to EBITDA. For taxable periods beginning on or after January 1, 2022, the calculation of ATI will be after depreciation, amortization or depletion (so similar to EBIT), thereby making new Section 163(j) more restrictive.

Again, the new Section 163(j) limitation applies not only to corporate borrowers but also to partnerships and other passthrough entities. Therefore, passthrough securitization vehicles need to be aware of these rules. The rules are more complicated for non-corporate borrowers since they need to grapple with whether interest income and interest deductions are "business interest income" and "business interest deductions" under the "trade or business" rules, discussed below. This is not an issue for corporations, since the Treasury has clarified that all interest income and deductions of corporations are "business interest income" and "business interest deductions," unless specifically excepted by some rule. For partnerships and trusts, careful diligence should be done to understand whether the income to the securitization vehicle is the type that qualifies as "business interest income," as these amounts may be fully offset (the new Section 163(j) limit does not apply) by interest deductions.

Unfortunately, as of the date of this publication, and despite over 400 pages of promulgated Treasury regulations, the issue of whether a securitization vehicle that is organized as a partnership or trust is engaged in a trade or business is not clear. The analysis is complicated by the fact that the new Section 163(j) limitation applies at the partnership level and then is allocated out to the partners, an "entity approach," whereas the other rule limiting the deductibility of investment interest (Section 163(d)), is determined at the partner level, an "aggregate approach." The result is that owners of the securitization vehicle could have interest limitation under new Section 163(j) allocated to them, but simultaneously have interest income treated as "investment interest income" under Section 163(d) (i.e., not eligible to be free of the new Section 163(j) limitation as "business interest income"). Commentators to the proposed regulations have identified this issue,[15] but the preamble to the regulations seem definitive, that this seemingly inconsistent treatment may apply to whipsaw the taxpayer.[16]

Further, to the extent that these passthrough vehicles produce out-sized income in early years and then more interest deductions in later years, the fact that the taxpayer cannot carryback excess Section 163(j) limitations in the later years could be problematic. If the owners of these securitization vehicles (trusts or partnerships) cannot treat the future allocation of interest as "business interest income," as discussed above, or perhaps because the allocation does not arise at all from a debt-receivable,[17] then this problem is more than a timing problem, it is permanent disallowance.

The potential problems for investors in securitization vehicles treated as passthrough entities for U.S. federal income tax purposes do not end with this issue of "business interest" versus "investment interest."

Because the new Section 163(j) limit is calculated at the partnership level, it is necessary to allocate various items to the partners in order to determine whether and the extent to which they will be allowed an interest deduction under the new Section 163(j).[18] The proposed regulations construct a plethora of new defined terms and a complex eleven-step analysis to deal with these allocation issues. A detailed discussion of those rules is beyond the scope of this chapter and in this author's opinion it is likely that the rules will be substantially changed in their final version. It is important to note, however, that the partner's tax basis in the partnership is reduced to the extent excess business interest expense is allocated to the partner, but to the extent this amount is not used it is reversed in the year the partner sells its partnership interest.[19]

These exceedingly complicated rules make one wonder if this is just another example of how the TCJA favors taxpayers operating in corporate form. This is because these complicated new Section 163(j) rules are much less complicated if the investor, who invests in the passthrough securitization vehicle, is a corporation. Such corporate investor would not need to worry about the "business interest" versus "investment interest" issue and so if the passthrough securitization entity is treated as not being engaged in a trade or business, there is no new Section 163(j) issue.[20] Further, the potential Section 163(d) limitation is pushed out to the partner level. At the partner level, Section 163(d) is not a problem because any net interest income or deduction would be converted to business income or deduction at the partner level, since the corporate partner cannot have investment interest income or deduction. Lastly, the corporate partner would do its own analysis under new Section 163(j), presumably taking full advantage of any net allocation of interest income or deduction, free of the complexities of new Section 163(j). This conclusion leaves open the question as to whether the securitization vehicle is engaged in a trade or business, which needs to be sorted through and likely will depend on the facts and circumstances of the situation. Again, even in the worst case scenario, where interest deductions generated by the passthrough securitization vehicle are denied at the partnership level and the excess business interest expense is allocated to partner, this should only be a timing issue, as the basis adjustment rules should allow the investor to recoup the benefit of the deduction at the time of disposition of the interest in the securitization vehicle.[21]

Another application of new Section 163(j) to lending transactions that was identified, but not addressed in the 400 plus pages of proposed regulations, relates to self-charged lending transactions. These are lending transactions between a partner and a partnership. The proposed regulations reserve on this issue, stating that rules will be forthcoming. One set of comments to the proposed regulations have suggested elegant ways to deal with these sorts of lending transactions.[22] We will have to wait and see what the IRS and Treasury ultimately decide.

The TCJA, and more accurately the proposed regulations under new Section 163(j), took a complicated landscape and littered it with landmines when it greatly expanded the definition of "interest." The traditional definition of interest is the compensation for the use or forbearance of money.[23] The IRS and Treasury, in an effort to foil attempts to get around the new Section 163(j) limitations, proffered an expansive and detailed definition of "interest," which includes three categories, briefly: (a) the traditional forbearance of money under a debt instrument or similar contract; (b) nonperiodic amounts in certain swaps; and (c) amounts closely related to interest that affect the economic yield or cost of funds of a transaction involving interest (even if such amounts are deductible under Section 162 instead of Section 163) (e.g., commitment fees and debt issuance costs). The first category can also include items that adjust the interest expense of the taxpayer, such as items of income, deduction, gain or loss from a derivative (as defined in Section 59A(h)(4)(A)) that affect the cost of borrowing.[24]

On top of all this, there is an anti-abuse rule, so that in the off chance that an item is not defined as "interest" under one of the 27 some odd categories of definitions in the proposed regulations, then the anti-avoidance provision is there to complicated things even further. Commentators and critics queried whether such a long list made the anti-avoidance provision more, or less, appropriate.

What this means, as a practical matter for cross-border lending transactions, is that deal parties will need to grapple with these concepts when negotiating terms of the credit facility, as the borrower will surely desire, to the extent possible, minimizing the amount of payments under the instrument that are subject to new Section 163(j). Further, there will also be follow-on effects, such as how the parties need to comply with withholding and reporting obligations for the payments, which obligations differ for interest and non-interest payments.

The above only skims the surface of new Section 163(j). We will have wait to see the changes made in the final regulations (expected at the end of June 2019). However, in transition into the next topic area, before leaving new Section 163(j), it is important to understand that for purposes of calculating the BEAT, interest *allowed* under new Section 163(j) is first allocated to related parties (proportionately between foreign and domestic related parties), then to unrelated parties. This allocation maximizes the potential amount of the BEAT under Section 59A.

While new Section 163(j) applies regardless of the relatedness of the parties, there are two other sets of rules that generally only apply to related party transactions: the BEAT and the Anti-Hybrid Rules. The BEAT only applies to related party payments, as do the Anti-Hybrid Rules, with one very important exception, discussed below.

The BEAT is a new tax introduced by the TCJA and operates as a minimum tax for U.S. companies. The BEAT only applies to taxpayers with at least $500 million in average annual gross receipts during the prior three years and further requires that the amount of "base eroding payments" (essentially deductible payments to related foreign recipients)[25] to the aggregate amount of deductible payments is at least 3% (2% for banks or registered securities dealers). The rate of the BEAT is 10% for taxable years 2019 through 2025 and 12.5% thereafter.[26] While the BEAT only applies to large companies, its impact can be devastating, as the 10% tax applies to a "modified taxable income" that is calculated by essentially adding back "base erosion tax benefits" and a portion of the taxpayer's NOLs. Further, modified taxable income cannot be reduced by foreign tax credits or certain other credits.

The BEAT is relevant to cross-border lending transactions not only because of the new Section 163(j) component, as discussed above, but it is another reason why U.S. companies will prefer to do their borrowing outside the U.S., via foreign subsidiaries perhaps, or also from third parties. It is also important for financial institutions to be aware of the special rules that relate to TLACs (total loss absorbing capacity), mark-to-market rules, and qualified derivatives (special reporting obligations apply in order to be able to exclude these payments from base eroding payments). Regarding the qualified derivative exception, it is important to note that it only applies to derivatives, not a direct contractual position (e.g., a repo or securities lending transaction).

Whereas the BEAT applies to only the largest of companies, but can have a tremendous impact if applicable, the new anti-hybrid rules can apply regardless of the size of the parties to a cross-border lending transaction and the impact can be just as severe. Here we are talking about the Section 267A anti-hybrid rules, not to be confused with the Section 245A(e) anti-hybrid rule that relates strictly to the participation exemption (Section 245A).

To repeat the good news, unlike new Section 163(j), the Section 267A rules *generally* only apply to deductions arising from transactions with related parties.[27] If applicable, Section 267A operates to deny deductibility of payments made pursuant to a "hybrid transaction" or by a "hybrid entity." The payment could be interest or royalties. In brief, a hybrid transaction is one that gives rise to a deduction for interest or royalties for U.S. federal income tax purposes, but is not treated as such under the laws of the foreign recipient. For example, this could include an instrument treated as debt for U.S. tax purposes but as equity for foreign tax law purposes. The rules apply to a hybrid entity where the entity is "fiscally transparent" for tax purposes of one jurisdiction, but as a taxable entity for purposes of the other jurisdiction.

This set of rules somewhat mirrors the OECD's approach.[28] However, the fact that the overlap is not perfect has led to considerable uncertainty, which, like many of the other aspects of the TCJA, is being worked out in the process of finalizing the proposed regulations, but no one expects the confusion to end in June 2019. Nevertheless, in the meantime, it is important to note that these rules will require, regardless of their final form, that parties to cross-border lending transactions evaluate whether interest deductions will be denied under these rules.

The rules essentially attack situations in which a payment is made that gives rise to a deduction (benefit) by one party and no inclusion in income (benefit) to the counterparty. This is referred to as "D/NI" or "DNI" or deduction/non-inclusion. This double benefit could also occur if there is a double non-inclusion as a result of the transaction.

It is important to keep in mind that the proscribed double benefit must arise from the hybridity, so if the hybridity is incidental to the transaction it will not result in the denial of the deduction to the U.S. taxpayer. As a practical matter, however, as these rules are very complicated, the default should be that parties should thoroughly diligence situations in which there is any hybridity in the structure, whether it is a hybrid entity or hybrid instrument.

The need for careful due diligence is more acute when it comes to two aspects of Section 267A: the imported mismatch rules and structured arrangements. This acuteness arises for two different reasons: "imported mismatches" involve hybridity that is "hidden;" and "structured arrangements" do not involve related parties. Thus, due diligence 101 requires that the parties to a cross-border financing look for hybridity ("**Due Diligence 101**"). Then, due diligence 201 requires one to search for "imported mismatches" and "structured arrangements," which, as we will see, are not exactly obvious situations ("**Due Diligence 201**").

Specifically, for example, an "imported mismatch" involves a U.S. borrower that is a party to a loan with a foreign related party. The loan is treated as debt under U.S. law and under the law of the foreign related party. Further, the U.S. borrower and foreign related parties are both regarded entities under both jurisdictions' laws. Thus, there is no hybridity. Does Section 267A apply? The answer is maybe. Due Diligence 101 is done, but Due Diligence 201 requires that we consider whether hybridity somewhere else offsets a non-hybrid "imported mismatch payment."[29] Specifically, a hybrid deduction offsets the non-hybrid "imported mismatch payment" if such payment is directly or indirectly funded by the hybrid deduction.

Thus, the key first step to Due Diligence 201 for imported mismatches is to identify whether such funding exists. What is complicated is the fact that money is fungible and such funding could come from any number of sources. To deal with this complexity, the proposed regulations provide an ordering rule.[30] First, the hybrid deduction offsets income that is factually-related to the imported mismatch payment that directly or indirectly funds the hybrid deduction. For this purpose, "factually-related imported mismatch payment" means a payment that is made pursuant to a transaction, agreement or instrument entered into pursuant to the same plan or series of related transactions. Second, any remaining amount of hybrid deduction offsets income attributable to an imported mismatch payment (other than factually-related payments) that directly funds the hybrid deduction. Third, any remaining amount of hybrid deduction offsets income attributable to an imported mismatch payment (other than a factually-related payment) that indirectly funds the hybrid deduction.

Generally, the "imported mismatch rules" apply to deny U.S. tax deductions for payments made by U.S. taxable entities and CFCs (e.g., the non-hybrid interest payment by the U.S. taxpayer arises from a loan to the U.S. entity that is funded with monies that relate to another transaction that involves a hybrid deduction). Those commenting on the proposed regulations point out that this approach is very similar to that taken by OECD BEPS2, but that there are serious risks of a double-disallowance of deduction unless the proposed regulations are modified to provide a mechanism to coordinate these rules with those in other jurisdictions.[31]

For "structured arrangements," the Due Diligence 201 is even more difficult. Before getting into the rules, it is important to note that the "structured arrangement" rules, like the "imported mismatch rules," are described in the proposed regulations, which are subject to change.[32] However, it is unlikely that the IRS and Treasury will completely abandon this expansion of Section 267A, as there is clear authority for what the IRS and Treasury did and there is a legitimate concern that, without these rules, planning around Section 267A would be too easy.

The simple, but not too useful, description of a "structured arrangement" is simply a transaction that would otherwise be covered by Section 267A, except that it is between *unrelated* parties or involves payments that are not interest or royalties. So, we are not looking for related parties, interest or royalties. What are we looking for in order to complete Due Diligence 201 for "structured arrangements"? The proposed regulations provide that we are looking for either (a) a situation where the hybrid mismatch is priced into the terms of the arrangement, or (b) the hybrid mismatch is a principal purpose of the arrangement.[33]

The first part of this test is presumably knowable by the parties to the arrangement and thus can be managed during the normal course of due diligence. That said it does impose an additional burden that the parties will have to incorporate into their deals. Below is a discussion of some possible approaches.

The second test is much more challenging. The proposed regulations provide four examples of facts and circumstances that indicate that the hybrid mismatch is a principal purpose of the arrangement: (a) marketing the arrangement as tax-advantaged where some or all of the tax advantage derives from the hybrid mismatch; (b) primarily marketing the arrangement to tax residents of a country the tax law of which enables the hybrid mismatch; (c) features that alter the terms of the arrangement, including the return, in the event the hybrid mismatch is no longer available; or (d) a below-market return absent the tax effects or benefits resulting from the hybrid mismatch.[34] Again, this "principal purpose" test is a subjective test: what is the intent of the taxpayer? This is different from OECD BEPS2, which uses an objective test: would an outsider conclude that the transaction was done with a "principal purpose" and did the taxpayer know (or should it have known)? Commentators have suggested specifically that the OECD BEPS2 objective test should be adopted in the final regulations.[35]

It is recommended that as part of "structured arrangement" Due Diligence 201, there be careful consideration to any "specified payment" that creates "interest-like" and "royalty-like" payments by using instruments that would not otherwise give rise to interest or royalties under U.S. tax law. There is a myriad of forms in which this could arise, as is highlighted with new Section 163(j)'s expansive view of "interest." Credit parties to cross-border lending transactions need to be alert. Further, if a "structured arrangement" is found, the work is not done, because it is possible that within a "structured arrangement" there could also be an "imported mismatch payment," so, see above regarding Due Diligence 201 for that set of rules.[36]

Practically, what are parties to cross-border lending transactions to do when considering Due Diligence 201? One possibility would be to handle these issues in the representation, covenant and indemnification provisions of credit agreements. However, current form credit agreements published by the Loan Syndications and Trading Association ("**LSTA**") and the Loan Market Association ("**LMA**") do not include, and do not lend themselves to adding, such provisions for "structured arrangements," especially with respect to banks. Generally, banks do not provide tax representations, except in the case of FATCA. It is yet to be seen whether these forms will change once the proposed regulations are finalized, which, again, is expected to be sometime before June 22, 2019. Regarding cross-border lending between parties not using LSTA or LMA form documents, which may arise where the lender is not a bank, and for purposes of preventing an "imported mismatch" (i.e., related party deals), it very well may be a viable solution to include representations that the conditions that would otherwise give rise to an "imported mismatch" or "structured arrangement" do not exist (representation), will not exist (covenant), and if they occur, will be compensated (indemnification).

D. Global Intangible Low-taxed Income (GILTI)

The TCJA introduces an entirely new anti-deferral tax that applies to foreign-sourced income earned by U.S. taxpayers of CFCs that is not Subpart F income and is not income that qualifies for the 100% deduction under Section 245A (the participation exemption). The GILTI generally does not have intrinsic elements that would implicate cross-border lending arrangements; however, a brief discussion of the new tax is warranted for several reasons. It is a new global minimum tax and while the effective rate of tax is 10.5% (rising to 13.125% in 2026), this effective rate is only available for U.S. shareholders that are corporations (or have elected to be treated as corporations under Section 962),[37] while non-corporate shareholders are subject to tax at ordinary income rates, without the benefit of foreign tax credit. Thus, GILTI is a significant new tax and despite its name, it applies to any type of income, intangible or not, since only a portion (10%) of tangible income is eligible for the Section 245A participation exemption.

Consequently, at a minimum, GILTI is relevant to lenders evaluating credit risk and borrowers attempting to rationalize their international capital stack to account for this new tax. Further, GILTI creates a new basket for foreign tax credits ("**FTCs**") and further only allows 80% of those FTCs. Lenders in repo and securities loan transactions, who are subject to tax withholding, could face excess foreign tax credit positions. The GILTI FTC limit of 80% also heightens the existing issue of how to withhold with respect to notional principal contracts.

E. Suspension of Miscellaneous Itemized Deductions – 67(g)

The TCJA suspended miscellaneous itemized deductions, effective in 2018 and through 2025.[38] The suspension of these deductions is potentially relevant to many different cross-border lending participants, but in particular certificate holders in securitizations. Such holders are generally subject to certain income and get the benefit of certain deductions at the time those items arise for the passthrough securitization vehicle (usually a trust or partnership). Prior to the suspension of these miscellaneous itemized deductions, owners of these securitization vehicles could offset some of the interest income generated by the securitization vehicle with deductions for servicing fees and other expenses generated by the trustee, subject to a 2% floor.[39] It is worth noting that this rule would not be relevant to securitization vehicles that are engaged in a U.S. trade or business for which Section 162 treatment is available (for deductions arising in the ordinary and necessary course of business). However, it is rare indeed to have such a securitization vehicle because usually it is critical to avoid U.S. trade or business status. Another thing to consider is whether a swap fee (or other similar fees) can be "integrated," to avoid this suspension, on the basis that the swap fee is effectively converted into "interest."[40]

F. Book Income Acceleration Rule – 451(b)

The reader should have noticed by now that the TCJA has a prejudice against debt. A keen example of that is the new Section 451(b).[41] Generally, Section 451 provides rules that determine when a U.S. taxpayer will include amounts into income. As a general matter, for an accrual basis taxpayer, amounts are included in income when the "all events test" is met, meaning when the right to receive the income is fixed and the amount of the income is determined with reasonable accuracy. There are exceptions to this general timing provision that allow for deferral or even exclusion of such income.

The TCJA's Section 451(b) mandates that an accrual basis taxpayer must treat the "all events test" as being met with respect to an item of income, no later than when the taxpayer includes such item as revenue on an "applicable financial statement" or any other financial statement as the Treasury specifies.[42] It is important to note at the start that this timing provision does not apply to (a) taxpayers that do not have financial statements, (b) mortgage servicing contracts,[43] and (c) taxpayers using special methods of accounting, other than those in part V or subchapter P of the Code (e.g., OID and market discount).[44] Further, Section 451(b) does not accelerate losses or deductions, only income.

For these purposes a "financial statement" not only includes statements filed with the S.E.C. (e.g., 10-K), but any audited financial statement that is used for (a) credit purposes, (b) reporting to shareholders, partners or other beneficiaries, or (c) any other substantial nontax purpose. It also includes a financial statement made on the basis of international financial reporting standards (IFRS) and which is filed by the taxpayer with an agency of a foreign government equivalent to the S.E.C. Lastly, it includes financial statements filed by the taxpayer with any other regulatory or governmental body specified by the Treasury.[45]

A main target of Section 451(b) is certain credit card fees and service contracts. Banks have traditionally reduced the issue price of its credit receivable by the amount of these fees and thereby, under the OID rules, deferred the inclusion into income, but at the same time, including the revenue amount on its financial statement. The IRS fought this position and lost in the Tax Court.[46] Section 451(b) sets out to reverse this result. Thus, if a taxpayer realizes certain fees on credit card loans that the OID rules would allow to be deferred, but the taxpayer includes those fees in revenue for financial statement purposes when received (e.g., late-payment fees, cash-advance fees or interchange fees), Section 451(b) now requires the taxpayer to recognize that fee income, before applying the OID rules.

The IRS and Treasury have yet to release proposed regulations in this area, although they have stated an intention to do so in a Notice.[47] This announcement specifically provides that Section 451(b) will not apply to include in income accrued market discount. This is important, for example, to finance parties that trade in distressed debt. For example, if a fund buys debt at 70 cents on the dollar (i.e., with market discount) and then such debt appreciates to 90 cents in value and the investor includes the 20 cent appreciation on its financial statement in accordance with GAAP, without an exception, Section 451(b) would have required the fund to include the 20 cents in income, even though it did not have the receipt of actual funds. Moreover, if the debt thereafter decreased in value to 50 cents, such investor would not be able to include such loss in income for tax purposes because Section 451(b) does not apply to losses (just income). Therefore, this Notice was welcome news to distressed debt funds and banks trading in distressed debt. However, further clarification on similar issues, such as how Section 451(b) affects OID other than in the case of fee income, should be contained in the forthcoming proposed regulations. Whether such regulations can be proposed and then finalized by June 22, 2019 will be challenging.

G. Transfers of Partnership Interests – Sections 864(c)(8) and 1446(f)

In another example of the TCJA overturning a Tax Court result,[48] the TCJA enacted Section 864(c)(8) so that a foreign person's gain or loss on the sale or exchange of a partnership interest would be treated as effectively connected with the conduct of a U.S. trade or business and thus potentially subject to U.S. taxation. Further, the TCJA creates a withholding mechanism under Section 1446 to compel the collection of any such tax.[49] The rate of withholding is 10% of the amount realized, not the proceeds of the sale.[50] Thus, such amount will include the selling partner's relief from debt. As partnerships are often leveraged, and securitization partnerships are heavily leveraged, this amount could far exceed the sale proceeds, and even the actual amount of tax owed on the sale.

The impact of these rules to cross-border lending transactions is, at a minimum, to heighten the sensitivities of non-U.S. lenders and their activities in the U.S. Typically, securitization vehicles get a legal opinion stating that they are not engaged in a U.S. trade or business. Still, the IRS could disagree and so a prudent transferee (purchaser) of the interest in such a vehicle should still get the certification from the seller.

The rules could apply in other cross-border lending transactions in which the buying party is uncertain as to whether the foreign owner is selling a partnership interest or not. For example, in some instances the seller holds what it believes to be a debt interest, but it is either more properly treated as a partnership interest or the underlying rights are equity-like. In these cases, the buyer may want to insist on getting a certificate.

As a practical matter, parties to credit agreements will need to carefully consider the credit agreement provisions so as to clearly define their intent and make that comport with the compliance obligations under Sections 864(c)(8) and 1446(f). The better these provisions, the more marketable the interest should be, as a buyer will not likely be motivated to take on undue risk.

H. Conclusion

The TCJA has changed numerous aspects of cross-border lending. The IRS and Treasury are still working out many of the details. We expect that many issues will be resolved with the forthcoming final regulations, which need to be issued by June 22, 2019 if they are going to be effective retroactively. Nevertheless, the prudent credit party should act now to advocate specific issues of concern directly or with the help of professional advisors. Credit parties should also not waste any time in taking a fresh look at credit agreements, organizational structures and other standard ways of practice (such as due diligence) when it comes to cross-border lending.

Endnotes

1. All references to "Code," "Section" or "§" are to the Internal Revenue Code of 1986, as amended, and the Treasury regulations promulgated thereunder.
2. This timetable allows the regulations to have retroactive effect to the date of the TCJA's enactment. § 7805(b)(2).
3. On top of the volumes of regulations proposed under the TCJA, the Treasury also issued new FATCA regulations in the middle of December 2018, which are not the subject of discussion herein, but did provide welcome relief regarding the treatment of gross receipts under FATCA. Such changes have already been reflected in the Loan Market Association ("**LMA**") model credit documents.
4. No member countries of the Organization for Economic Cooperation and Development ("**OECD**") have a "pure" tax system.
5. This would require, for example, that the earnings were not U.S.-sourced, that the one-year holding period was met and the instrument was not a hybrid instrument.
6. It is yet to be seen whether state and local jurisdictions will fully adopt Section 245A and so it is possible that there could be some SALT applicable to any Section 956 deemed dividend, even if Section 245A and the Section 956 proposed regulations apply.
7. *See*, General Explanation of Public Law 115-97, Joint Committee on Taxation (Dec. 2018).
8. Section 245A(e).
9. Section 245A(e).
10. Prop. Reg. § 1.163(j)-7(b)(4)(i).
11. Reg. 130244-17, Fed. Reg., vol. 83, No. 185, p. 48265 (September 24, 2018). While the technical effective date of the proposed regulations occurs when they are finalized, because they provide that taxpayers can rely on them until such time, the documentation rules have effectively been removed.
12. There are also exceptions for real estate and farming businesses, as well as REMICs (real estate mortgage investment conduits).
13. This special exception applies to business, such as automotive dealers, who finance inventory.
14. For partnerships, the Section 163(j) limitation applies at the partnership level but the carryover applies at the partner level based on very complicated rules. The limitation also applies at the consolidated group level for taxpayers in a U.S. federal income tax consolidated group (treating the group as one taxpayer).
15. *See*, New York State Bar Association Tax Section Report No. 1412, *Report on Proposed Section 163(j) Regulations*, at pp. 34–35 (February 26, 2019) (hereinafter, "**NYSBA 163(j) Report**").
16. *See*, Proposed Regulations, REG-106089-18, at page 85.
17. This could arise if the receivables relate to royalties, causes of action or operating revenues, just to name a few examples.
18. The income of the partner is irrelevant to ATI. An extreme example illustrates this point. Assume a billionaire invests in a start-up company with substantial capitalized costs, so

while it has $30 million of gross receipts it has very little ATI and assumes no "business interest income." The billionaire could have millions of ATI and millions of "business interest income", unrelated to the start-up company, so that the result could be that a $1 million interest payment by the start-up may be severely limited under new Section 163(j), and this limit would apply to the billionaire partner, despite significant partner-level income and "business interest income". This problem becomes more acute after 2021, when depreciation, amortization and depletion are no longer added back to calculate ATI.

19. Section 163(j)(4)(B)(iii). *See also*, Proposed Regulations § 1.163(j)-6(h)(3).
20. *See*, Prop. Regs. § 1.163(j)-4(b).
21. Section 163(j)(4)(B)(iii)(II).
22. *See*, NYSBA 163(j) Report, at 51–52.
23. *Deputy v. DuPont*, 308 U.S. 488, 498 (1940). *See also*, Section 461(g).
24. Prop. Reg. § 1.163(j)-1(b)(20)(iii)(E), (F).
25. Relatedness is determined with respect to the U.S. taxpayer and includes (a) any 25% owner of the taxpayer, (b) any person who is related (within the meaning of Sections 267(b) or 707(b)(1)) to the taxpayer or any 25% owner of the taxpayer, and (c) any other person who is related (within the meaning of Section 482) to the taxpayer. Constructive ownership rules apply for these purposes to attribute ownership between certain parties. Sections 59A(g)(3), 318.
26. The rate for 2018 was 5%. Importantly for banks (as defined in Section 581) and registered securities dealers (under section 15(a) of the Securities Exchange Act of 1934), the rate of BEAT is 1% higher for all applicable periods (6%, 11% and 13.5%).
27. There is an important exception for "structured arrangements" that is discussed below. For purposes of Section 267A, relatedness exists if one party controls or is controlled by the other party to the transaction, where "control" means ownership of more than 50% of the voting stock of a corporation or more than 50% of the value of the interests in a partnership, limited liability company, trust or estate. Sections 267A(b)(2), 954(d)(3). Constructive ownership rules apply to attribute ownership between certain parties for these purposes, but thankfully the downward attribution rules do not apply. *See*, Prop. Reg. § 1.267A-5(a)(14).
28. *See*, OECD/G20, Neutralising the Effects of Hybrid Mismatch Arrangements, Action 2: 2015 Final Report (2015) and OECD/G20, Neutralising the Effects of Branch Mismatch Arrangements, Action 2: Inclusive Framework on BEPS (2017) (collectively, "**OECD BEPS2**").
29. Prop. Reg. § 1.267A-4(a).
30. Prop. Reg. § 1.267A-4(c)(2).
31. New York State Bar Association Tax Section Report No. 1411, *Report on Proposed Regulations Under Sections 267A, 245A(e) and 1503(d)*, at page 34 (February 26, 2019) (hereafter, "**NYSBA 267A Report**").
32. Section 267A(e)(3) grants the Treasury the authority to promulgate regulations, and that is just what the Treasury did. *See*, Prop. Reg. § 1.267A-2(f).
33. Prop. Reg. § 1.267A-5(a)(20). This two-part test is different from the OECD BEPS2 approach, which also has a two-part test, with the pricing rule, but importantly, the second test is an objective test that asks whether the facts and circumstances indicate that the arrangement is designed to produce a hybrid mismatch. Further, and critically, the OECD BEPS2 approach requires that the taxpayer could reasonably be expected to be aware of the hybrid mismatch or otherwise shared in the value of the tax benefit resulting from the hybrid mismatch. Commentators have argued that the U.S. should consider following the OECD rules. *See*, NYSBA 267A Report, at page 26.
34. Prop. Reg. § 1.267A-5(a)(20)(ii)(A)-(D).
35. NYSBA 267A Report, at pages 29–32.
36. Prop. Reg. § 1.267A-4(a).
37. A Section 962 corporation is a created when an individual or partnership, for example, makes an election to treat its ownership of a CFC as being held by a fictitious U.S. C corporation. The Treasury clarified the fact that a Section 962 corporation is entitled to the Section 250 deduction in its Section 250 proposed regulations, issued on March 4, 2019.
38. Section 67(g).
39. Section 67(a).
40. Treas. Reg. § 1.1275-6.
41. The TCJA slipped this new rule in between old Section 451(a) and old Section 451(b), shifting all the other subparagraphs down the alphabet, so old Section 451(b) is now Section 451(c) and so on.
42. Section 451(b).
43. Section 451(b)(1)(B)(ii). This exception likely applies to commercial and residential mortgages. This exception is important since a disposition of mortgages, with the transferor retaining the servicing rights (income), would not result in present taxation even though, under GAAP, the transferor can show the servicing fees as revenue on its balance sheet. *See*, Peaslee and Nirenberg, Federal Income Taxation of Securitization Transactions and Related Topics, Fifth Ed. (2018) at pages 821–832.
44. Section 451(b)(2).
45. Section 451(b)(3)(A)-(C). These rules prioritize any statement filed with the S.E.C.
46. *Capital One Financial Corp. and Subsidiaries v. Commissioner*, 133 T.C. 8 (2009).
47. Notice 2018-80, 2018-42 I.R.B. (September 27, 2018).
48. *See*, *Grecian Magnesite Mining, Industrial & Shipping Co., SA v. Commissioner*, 149 T.C. 3 (2017).
49. Section 1446(f).
50. The IRS provided relief from these rules to publicly traded partnerships. Notice 2018-08, 2018-05 I.R.B. (December 29, 2017).

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Mr. Cox assists in developing effective tax strategies for complex cross-border and domestic business transactions. He advises banks, issuers and other parties regarding the U.S. federal income tax implications and opportunities relating to capital markets transactions, project finance, securitizations, structured finance and credit facilities, including extensive experience with the recent U.S. tax reform (Tax Cuts and Jobs Act – 2017). He counsels clients regarding FATCA and FBAR compliance issues.

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Chapter 29

Angola

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1 Overview

1.1 What are the main trends/significant developments in the lending markets in your jurisdiction?

Due to the significant fall in oil prices in international markets, since June 2014, the national economy has faced (i) a contraction in economic activity, (ii) an exponential increase in inflation rates, (iii) a deterioration in the indicators of the fiscal sector, although the significant efforts of the Government to improve the collection of taxes in other sectors of the economy, (iv) a significant fall in net international reserves, and (v) a lending squeeze on the economy, which has conditioned the development of the private sector.

1.2 What are some significant lending transactions that have taken place in your jurisdiction in recent years?

The landmark lending transactions in 2018 have been: (i) the EUR 247.8 million loan from Standard Chartered Bank (SCB) for financing the construction project of the transport system of energy associated with the utilisation of the Laúca hydropower plant by the Angolan Government; (ii) the USD 500 million loan from Gemcorp Capital for financing the import of goods and equipment under the Public Investment Programme to the Angolan Government; (iii) the USD 500 million loan from UK EXPORT FINANCE for financing the implementation of the projects provided in the Public Investment Programme with no guaranteed financing to the Angolan Government; (iv) the USD 700 million loan from Banco Credit Suisse for financing Strategic Projects to the Angolan Government; (v) the USD 250 million loan from Gemcorp to meet treasury needs to the Angolan Government; (vi) the USD 1,000 million loan from African Export-Import Bank (AFREXIMBANK) for financing industrialisation projects in the private sector to the Angolan Government; (vii) the USD 500 million loan from African Export-Import Bank (AFREXIMBANK) for financing the import of consumer goods for the defence, interior, health and security sectors of the Angolan State to the Angolan Government; and (viii) the EUR 1,060 million loan from the consortium formed by UniCredit and Commerzbank to cover the contract for the supply and installation of equipment associated with the Caculo Cabaça hydropower plant to the Angolan Government.

2 Guarantees

2.1 Can a company guarantee borrowings of one or more other members of its corporate group (see below for questions relating to fraudulent transfer/financial assistance)?

As a general rule, the corporate powers of a company are restricted to those rights and obligations necessary or appropriate to pursuing the corporate object of the company (which, generally, is to make a profit).

Under Article 6(3) of the Angolan Companies Law, there is a legal presumption that granting of guarantees in respect of obligations of other entities is contrary to the purpose of companies, unless there is a justifiable own interest of the company in providing the guarantee or the company in question is in a group or control relationship with the other company.

Such a justifiable own interest of the company is evident in the provision of downstream guarantees, but is less evident in the provision of upstream and cross-stream guarantees. In the case of upstream and cross-stream guarantees, it is advisable for the necessary resolutions to be passed justifying the own interest of the company, which may be an indirect one, in providing the guarantee.

2.2 Are there enforceability or other concerns (such as director liability) if only a disproportionately small (or no) benefit to the guaranteeing/securing company can be shown?

In such situations, it is likely that there is no justifiable own interest to the company in providing the guarantee/security and, unless the company is in a group or control relationship with the entity whose obligations it guarantees/secures, the provision of the guarantee/security may be considered null and void.

Pursuant to Article 1175 of the Angolan Civil Procedure Code, in the absence of benefit or the existence of only a disproportionately small benefit to the company, the provision of the guarantee/security may be terminated in the context of insolvency proceedings relating to the company if the guarantee/security is provided during the two-year period prior to the declaration of insolvency.

The provision of the guarantee or security with disproportionate, small (or no) benefit to the company may give rise to the breach of duties of directors towards the company and, therefore, liability.

2.3 Is lack of corporate power an issue?

Yes; please see question 2.1 above.

2.4 Are any governmental or other consents or filings, or other formalities (such as shareholder approval), required?

Except for certain state-owned and other public sector companies, in principle, no governmental approvals, consents or filings are required by law, for a guarantee provided by an Angolan company to be enforceable.

However, for a guarantee provided by an Angolan company to be enforceable, shareholder approval or board approval is required by the Angolan Companies Law. Usually, such approval will contain an express reference to the benefit of the company from the provision of the guarantee (even if such benefit is an indirect one) or to the controlling or group relationship (if any) with the entity benefiting from the provision of the guarantee.

2.5 Are net worth, solvency or similar limitations imposed on the amount of a guarantee?

No, but please see question 2.2 above as to corporate benefit.

2.6 Are there any exchange control or similar obstacles to enforcement of a guarantee?

No exchange controls or other obstacles exist in Angola regarding the enforcement of a guarantee. Regarding enforcement of cross-border guarantees, exchange controls do not apply.

3 Collateral Security

3.1 What types of collateral are available to secure lending obligations?

Under book II, chapter VI of the Angolan Civil Code there are various types of collateral available to secure lending obligations, such as:

(i) provision of bonds;
(ii) bail;
(iii) consignation of income;
(iv) pledge;
(v) mortgage; and
(vi) right of retention.

3.2 Is it possible to give asset security by means of a general security agreement or is an agreement required in relation to each type of asset? Briefly, what is the procedure?

Under Angolan law, the provision of general security (i.e. over the assets of a given entity generally) is considered null and void because of lack of determination of the specific assets that become subject to the security.

It is therefore necessary for a security agreement to identify, to the greatest extent possible, the assets subject to the security created by the agreement. The security agreement must contain at least certain criteria that would make it possible to identify the secured assets at a given time.

The use of one single agreement or separate agreements will depend on the type of security being granted, as mortgages and consignation of income must be granted by public deed, whereas pledges may be granted by means of private agreements.

3.3 Can collateral security be taken over real property (land), plant, machinery and equipment? Briefly, what is the procedure?

Yes, collateral security may be taken over such assets by means of a deed of mortgage.

A mortgage over a factory will include the real estate and all the machinery and equipment thereof which is identified in a schedule to the deed.

3.4 Can collateral security be taken over receivables? Briefly, what is the procedure? Are debtors required to be notified of the security?

Yes, collateral security by means of a pledge over receivables may be taken. The most common form of collateral security over receivables is a pledge of credits, which is created by a written agreement and is subject to the notification of the creation of the pledge to the debtors, so that the pledge may be enforced against such persons.

3.5 Can collateral security be taken over cash deposited in bank accounts? Briefly, what is the procedure?

Yes, collateral security by means of a pledge over cash deposited in bank accounts may be taken and is deemed as a pledge of credits (see question 3.4 above).

3.6 Can collateral security be taken over shares in companies incorporated in your jurisdiction? Are the shares in certificated form? Can such security validly be granted under a New York or English law governed document? Briefly, what is the procedure?

Yes, collateral security may be taken over shares in companies incorporated in Angola as a pledge of shares.

Shares may be either in certificated form or in book-entry form. Yes, provided that any formalities required under Angolan law for the validity and effectiveness of the pledge are complied with. The procedure will depend on the type of company in question.

If the company is a private limited liability company (*sociedade por quotas*), registration of the pledge over the shares at the Commercial Registry is required.

If the company is a public limited liability company (*sociedade anónima*), a pledge of shares of this type of company requires, if the shares are in certificate form, the annotation of the creation of the pledge on each share certificate and registration of the pledge in the books of the issuer. The creation of the pledge over book-entry shares is made by annotation of the creation of the pledge in the securities account in which the shares are deposited and registration in the books of the issuer.

3.7 Can security be taken over inventory? Briefly, what is the procedure?

Security over inventory is possible and it requires the execution of a written agreement. Upon default or the occurrence of other circumstances as set out in the pledge agreement, it is customary for the pledgee or security agent to give an enforcement notice to the pledgor crystallising the stock. Alternatively, parties may agree on the provision of regular notices detailing the pledged stock.

3.8 Can a company grant a security interest in order to secure its obligations (i) as a borrower under a credit facility, and (ii) as a guarantor of the obligations of other borrowers and/or guarantors of obligations under a credit facility (see below for questions relating to the giving of guarantees and financial assistance)?

Yes, but please see the restrictions on the provision of guarantees in question 2.1 above, which are also applicable in relation to the provision of security interest by companies.

3.9 What are the notarisation, registration, stamp duty and other fees (whether related to property value or otherwise) in relation to security over different types of assets?

The costs for the creation of security are, generally, as follows:

(i) notarial fees (only applicable where the execution of a public deed is required): depends on the nature, complexity and value of the act to be executed;

(ii) registration fees: depends on the nature of the act and the value of the share capital; and

(iii) stamp duty (please see below as regards the applicability of stamp duty): depends on the nature and complexity of the act to be executed.

3.10 Do the filing, notification or registration requirements in relation to security over different types of assets involve a significant amount of time or expense?

In principle there should be no timing issues. Filings, notifications and registrations are made in a matter of a few days.

As regards expenses, these can be a considerable amount in the event that stamp duty is due on the granting of guarantees or the creation of security.

3.11 Are any regulatory or similar consents required with respect to the creation of security?

No regulatory or similar consents apply, except for assets held by state-owned entities or shares of concessionaires of public services, which must be assessed on a case-by-case basis.

3.12 If the borrowings to be secured are under a revolving credit facility, are there any special priority or other concerns?

No, there are not. In any case, please note that the creditors benefitting from *in rem security* have a privileged status in accordance with the Angolan Civil Procedure Code. The fact that the credit facility is a revolving one does not affect priority or raise other concerns.

3.13 Are there particular documentary or execution requirements (notarisation, execution under power of attorney, counterparts, deeds)?

Yes, the creation of security over real estate requires the execution of a deed, to be made before a notary. In such case, the powers of attorney, if any, must also be granted before a public notary. For the execution of a deed in Angola, notaries require the parties (whether Angolan or foreign entities) to have an Angolan tax identification number. The provision of such number is also required for the registration of a security interest in favour of a given entity.

4 Financial Assistance

4.1 Are there prohibitions or restrictions on the ability of a company to guarantee and/or give security to support borrowings incurred to finance or refinance the direct or indirect acquisition of: (a) shares of the company; (b) shares of any company which directly or indirectly owns shares in the company; or (c) shares in a sister subsidiary?

(a) Shares of the company

Yes, this is expressly forbidden in accordance with Article 344 of the Angolan Companies Law. Few exceptions are available. The violation of this prohibition may lead to criminal liability of the directors/managers of such company and the agreement, guarantee or security interest may be declared null and void.

(b) Shares of any company which directly or indirectly owns shares in the company

No express prohibition exists, but it is generally understood as applicable. Also, please note that the corporate powers of the company may be restricted in respect of granting of guarantees or security – please see question 2.1 above.

(c) Shares in a sister subsidiary

No express prohibition exists, but please note that the corporate powers of the company may be restricted in respect of granting of guarantees or security – please see question 2.1 above.

5 Syndicated Lending/Agency/Trustee/Transfers

5.1 Will your jurisdiction recognise the role of an agent or trustee and allow the agent or trustee (rather than each lender acting separately) to enforce the loan documentation and collateral security and to apply the proceeds from the collateral to the claims of all the lenders?

The role of the agent acting on behalf of the secured creditors will be recognised in Angola, provided that the agent is also a secured creditor, which is usually the case. This requirement derives from the fact that, under Angolan law, only an entity which is a creditor may request the registration of the security in its own name. In such circumstances, and besides the fact that the agent is also named as secured creditor in the documentation, the documentation must provide that the agent will also be acting as a representative of the other creditors in enforcing the security.

The role of the trustee is not recognised in Angola.

5.2 If an agent or trustee is not recognised in your jurisdiction, is an alternative mechanism available to achieve the effect referred to above which would allow one party to enforce claims on behalf of all the lenders so that individual lenders do not need to enforce their security separately?

This is not applicable in Angola.

5.3 Assume a loan is made to a company organised under the laws of your jurisdiction and guaranteed by a guarantor organised under the laws of your jurisdiction. If such loan is transferred by Lender A to Lender B, are there any special requirements necessary to make the loan and guarantee enforceable by Lender B?

Yes, notice to the borrower and guarantor of the assignment is required, as well as registration of the security (if subject to registration) with the relevant registry (land registry, commercial registry, car registry, financial intermediary or company books, as applicable).

In addition, please note that the assignment of security against a company which is in an insolvency proceeding will, from a practical perspective, also require notification to the court of the assignment so that the new creditor can be recognised in the insolvency proceeding.

However, please note that there might be situations in which the guarantee may not be assigned. For example, if the parties have restricted the ability of the guarantor to assign, or if the guarantee has been provided *intuitu personae* (i.e. the nature of the guarantee is not separable from the person or the borrower).

6 Withholding, Stamp and Other Taxes; Notarial and Other Costs

6.1 Are there any requirements to deduct or withhold tax from (a) interest payable on loans made to domestic or foreign lenders, or (b) the proceeds of a claim under a guarantee or the proceeds of enforcing security?

Payments of interest by an Angolan company to a foreign lender will be subject to withholding tax, currently at a rate of 15 per cent. The proceeds of a claim under a guarantee or the proceeds of enforcing security are not subject to withholding tax.

6.2 What tax incentives or other incentives are provided preferentially to foreign lenders? What taxes apply to foreign lenders with respect to their loans, mortgages or other security documents, either for the purposes of effectiveness or registration?

In general, there are no tax incentives to foreign lenders in the context of bank lending transactions, in contrast to the general tax exemption applicable to foreign bondholders.

6.3 Will any income of a foreign lender become taxable in your jurisdiction solely because of a loan to, or guarantee and/or grant of, security from a company in your jurisdiction?

The income of a foreign lender deriving from payments of interest will become taxable in Angola by virtue of the borrower being considered tax resident in Angola. Please note that, as mentioned in question 6.1 above, there will be withholding tax on the payments of interest in such situation.

6.4 Will there be any other significant costs which would be incurred by foreign lenders in the grant of such loan/guarantee/security, such as notarial fees, etc.?

There are other costs, such as notarial fees and land registry fees, for the registration of a mortgage over real estate. These will not be significant unless the security is granted over several properties.

According to the Regulation of the Fees for Registration of the Property, the cost of registration of a mortgage depends on the value of the property and the complexity of the act to be registered.

6.5 Are there any adverse consequences for a company that is a borrower (such as under thin capitalisation principles) if some or all of the lenders are organised under the laws of a jurisdiction other than your own? Please disregard withholding tax concerns for purposes of this question.

No specific adverse consequences (other than described above as to withholding tax) will arise by virtue of the lenders being incorporated outside Angola.

7 Judicial Enforcement

7.1 Will the courts in your jurisdiction recognise a governing law in a contract that is the law of another jurisdiction (a "foreign governing law")? Will courts in your jurisdiction enforce a contract that has a foreign governing law?

Under the general principle set out in the Angolan Civil Code, the parties to an agreement may choose the governing law of the agreement, provided their choice corresponds to a serious interest of the parties or is the law of a jurisdiction which has a relevant connection with the agreement and is legitimate in the context of the principles of private international law.

7.2 Will the courts in your jurisdiction recognise and enforce a judgment given against a company in New York courts or English courts (a "foreign judgment") without re-examination of the merits of the case?

To produce effects in Angola, including for purposes of enforcement, a final judgment obtained in a competent foreign jurisdiction has to be recognised first, by means of court proceedings under the conditions set out in the Angolan Civil Procedure Code. There is no review of the merits of the judgment and there are limited grounds (mostly procedural) that can be invoked to try to avoid recognition.

7.3 Assuming a company is in payment default under a loan agreement or a guarantee agreement and has no legal defence to payment, approximately how long would it take for a foreign lender to (a) assuming the answer to question 7.1 is yes, file a suit against the company in a court in your jurisdiction, obtain a judgment, and enforce the judgment against the assets of the company, and (b) assuming the answer to question 7.2 is yes, enforce a foreign judgment in a court in your jurisdiction against the assets of the company?

In general, filing a suit in Angola, obtaining a judgment and enforcing it could take 36 months on average. Enforcing a foreign judgment in Angola against the assets of a company could take 18 months. In both scenarios, the timeframe for enforcement of the court decision will depend on how long it takes to identify the assets to be seized.

7.4 With respect to enforcing collateral security, are there any significant restrictions which may impact the timing and value of enforcement, such as (a) a requirement for a public auction, or (b) regulatory consents?

Yes, timing of the enforcement may be affected in the event that there is a public auction of the assets or in the event that such auction is not successful, if, for instance, no offers higher than the reserve amount are received.

Regulatory consents may also impose a significant delay in the conclusion of the enforcement in the event that the sale of the enforced assets to the acquirer is subject to obtaining regulatory consents, in the context of competition laws or sectoral regulation (sale of qualified shareholdings in financial institutions, defence industries, public services concessionaires).

7.5 Do restrictions apply to foreign lenders in the event of (a) filing suit against a company in your jurisdiction, or (b) foreclosure on collateral security?

No, in principle, no such restrictions will apply.

7.6 Do the bankruptcy, reorganisation or similar laws in your jurisdiction provide for any kind of moratorium on enforcement of lender claims? If so, does the moratorium apply to the enforcement of collateral security?

Yes, in accordance with the Angola Civil Procedure Code, the start of a bankruptcy proceeding will imply a moratorium on the enforcement of collateral security against the insolvent or quasi-insolvent borrower or guarantor.

7.7 Will the courts in your jurisdiction recognise and enforce an arbitral award given against the company without re-examination of the merits?

The Angolan Republic is a party to the New York Arbitration Convention and therefore any arbitral awards given in another contracting state will be recognised without re-examination of the merits of the claim.

In relation to arbitral awards given in a state which is not a party to the New York Arbitration Convention, or any other convention to which the Angolan state is a party, the enforcement of an arbitral award in Angola is subject to the recognition of such award by a court in Angola, irrespective of the nationality of the parties.

8 Bankruptcy Proceedings

8.1 How does a bankruptcy proceeding in respect of a company affect the ability of a lender to enforce its rights as a secured party over the collateral security?

Under Article 1142(3) of the Angolan Civil Procedure Code, the start of a bankruptcy proceeding will suspend all enforcement proceedings against the company.

8.2 Are there any preference periods, clawback rights or other preferential creditors' rights (e.g., tax debts, employees' claims) with respect to the security?

Under Article 1175 of the Angolan Civil Procedure Code there is a two-year period of suspicion during which any acts that are "prejudicial" to the bankrupt entity and carried out in bad faith will be set aside.

In addition, Article 1212 of the Angolan Civil Procedure Code sets out the specific situations in which certain acts may be set aside.

Under the Angolan Civil Code there is also a concept of *impugnação pauliana* (Paulian Action) pursuant to which an action could be brought by a creditor to set aside a transaction that result in a decrease of the bankrupt company's assets and in circumstances in which there was no consideration provided certain requirements are met.

Preferential creditor's rights exist under Angolan law, such as court fees, tax debts and employees' claims.

8.3 Are there any entities that are excluded from bankruptcy proceedings and, if so, what is the applicable legislation?

Yes, the Angolan Republic and certain public sector entities, particularly financial institutions, are excluded from the bankruptcy proceedings set forth in the Angolan Civil Procedure Code. Financial institutions are subject to the specific regime set forth in Article 109 and Articles 121 to 136 of the Angolan Financial Institutions Law.

8.4 Are there any processes other than court proceedings that are available to a creditor to seize the assets of a company in an enforcement?

In accordance with (i) the Angolan Civil Code, and (ii) the Angolan Commercial Code, it is possible for the enforcement of a pledge to be conducted out of court.

In the case of a pledge created under the rules of the Angolan Civil Code, the parties may agree to an out-of-court sale of the pledged assets. Please note, however, that in this situation, the pledged assets will, in principle, be in the possession of the pledgee or a custodian appointed by the parties.

9 Jurisdiction and Waiver of Immunity

9.1 Is a party's submission to a foreign jurisdiction legally binding and enforceable under the laws of your jurisdiction?

Yes, please see answer to question 7.2 above.

9.2 Is a party's waiver of sovereign immunity legally binding and enforceable under the laws of your jurisdiction?

In the event that an entity benefits from sovereign immunity, the waiver of the benefit of such immunity will be valid. However, it should be noted that the assets of such entity which are in the public domain (*domínio público*) or used for the purpose of pursuing a public service may not be seized and the entity may not waive immunity over such assets, unless there is a specific law approved for such purpose.

10 Licensing

10.1 What are the licensing and other eligibility requirements in your jurisdiction for lenders to a company in your jurisdiction, if any? Are these licensing and eligibility requirements different for a "foreign" lender (i.e. a lender that is not located in your jurisdiction)? In connection with any such requirements, is a distinction made under the laws of your jurisdiction between a lender that is a bank *versus* a lender that is a non-bank? If there are such requirements in your jurisdiction, what are the consequences for a lender that has not satisfied such requirements but has nonetheless made a loan to a company in your jurisdiction? What are the licensing and other eligibility requirements in your jurisdiction for an agent under a syndicated facility for lenders to a company in your jurisdiction?

Under the Angolan Financial Institutions Law, only licensed entities may carry out lending activity in Angola on a professional basis. The provision of loans to Angolan entities on a professional and regular basis will trigger a licensing requirement in Angola. However, if a foreign entity provides loans to Angolan entities on a single or very infrequent basis no licensing requirement will apply as the foreign lender may be deemed not to be carrying out activity in Angola, which assumes a repetition of acts or transactions in Angola.

11 Other Matters

11.1 Are there any other material considerations which should be taken into account by lenders when participating in financings in your jurisdiction?

We believe that questions above fairly address the main material issues that arise generally in the context of lending transactions.

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ADVOGADOS

Bravo da Costa, Saraiva – Sociedade de Advogados ("BCSA") is a law firm that brings together a group of leading Angolan legal professionals who share a firm interest and great satisfaction in working in Angola for Angola in strict compliance with the professional and ethical rules of the Angolan Bar Association.

BCSA's lawyers have signed a cooperation agreement with PLMJ under which they ensure local support for clients of PLMJ Network. The services BCSA provides are backed up by close cooperation with the lawyers of the PLMJ Africa Desk and this is a close and ongoing partnership that results in the provision of highly specialised services with a great deal of added value and enormous technical quality for all our clients.

BCSA's team of professionals is made up of a number of lawyers with differing professional interests and levels of seniority who have professional and academic experience gained in Angola and other countries.

Chapter 30

Argentina

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Marval, O'Farrell & Mairal

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1 Overview

1.1 What are the main trends/significant developments in the lending markets in your jurisdiction?

The main significant developments were (i) the abrogation of the foreign exchange restrictions which have been adopted in Argentina since 2001, mainly affecting cross-border financing, and (ii) the creation of the role of collateral agent for financial collectives.

Since December 17, 2015, the elected authorities in Argentina have been implementing a series of measures to progressively deregulate and implement more flexible regulations.

In May 2018, the Argentine Congress passed Law No. 27,440, which creates the role of collateral agent for financial collectives. Said Law states that in financing contracts with two or more lenders, the parties may agree to the creation of mortgage and pledge guarantees in favour of a collateral agent, who will act for the benefit of the creditors, and that, in such case, the secured loans may be transferred to third parties, who will be beneficiaries of the guarantee in the same terms as the assignor, not being applicable. In this way, the holder of the guarantee is dissociated from the holders of the secured loans, and the transfer of credits is permitted without the necessity of modifying the mortgage and pledge guarantees.

These developments, together with other economic and political measures taken by the new administration, are starting to create a new investment environment that has begun to show an increase in cross-border financing.

1.2 What are some significant lending transactions that have taken place in your jurisdiction in recent years?

- In 2018, CVI Investment Holdings Limited granted Supercanal S.A. a US$ 63,000,000 loan.
- In 2018, ING Capital LLC and Itaú Unibanco S.A., New York Branch granted CPS Comunicaciones S.A. a US$ 60,000,000 loan.
- In 2018, BNP Paribas granted Volkswagen Argentina S.A. a US$ 30,000,000 loan.
- In 2018, BNP Paribas granted YPF a US$ 50,000,000 loan.
- In 2018, Citibank N.A., HSBC México S.A., Industrial and Commercial Bank of China Limited Dubai Branch, JPMorgan Chase Bank N.A. and Banco Santander S.A. granted Telecom Argentina S.A. a US$ 500,000,000 loan.
- In 2017, Banco de la Ciudad de Buenos Aires granted Araucaria Energy S.A. a US$ 25,000,000 loan.
- In 2017, Citibank N.A., Goldman Sachs Bank USA, Industrial and Commercial Bank of China Limited Dubai (DIFC) Branch and Itaú Unibanco S.A. Nassau Branch granted Cablevisión Holding S.A. a US$ 750,000,000 loan.
- In 2017, Industrial and Commercial Bank of China (Argentina) S.A., Banco de Galicia y Buenos Aires S.A. and General Electric Company granted UENSA y UGEN (MSU Energy Group) a US$ 230,000,000 loan.
- In 2017, Japan Bank for International Cooperation and Deutsche Bank AG granted the Argentine Republic a US$ 51,000,000 loan.
- In 2016, International Finance Corporation granted Adeco Agropecuaria S.A./Pilaga S.A. a US$ 50,000,000 loan.
- In 2016, ICBC, Dubai Branch granted Loma Negra Compañía Industrial Argentina S.A. a US$ 50,000,000 Medium-Term Facility.

2 Guarantees

2.1 Can a company guarantee borrowings of one or more other members of its corporate group (see below for questions relating to fraudulent transfer/financial assistance)?

Yes, it is possible to secure the borrowings of other members of the corporate group. The company acting as a guarantor should receive proper (arm's-length) benefits or consideration in return. Otherwise, it may be considered that the granting of the guarantee derives no benefit for the securing company and, hence, other creditors could challenge such transaction.

In addition, the by-laws of the securing company should include the prerogative to grant borrowings to third parties or, alternatively, the main activity of the company should be financing. Nevertheless, certain jurisprudence resolved that if the by-laws do not include said prerogative, the irregularity may be fixed by a subsequent ratification of the shareholders.

These requirements should be strictly defined when the guarantee is upstream (a controlled entity acting as guarantor of an obligation of its direct or indirect parent company or an affiliate).

2.2 Are there enforceability or other concerns (such as director liability) if only a disproportionately small (or no) benefit to the guaranteeing/securing company can be shown?

If the securing company does not have any financial corporate purpose, nor receives a consideration or benefit, the guarantee may be deemed out of the scope of the securing company's corporate purpose (*ultra vires*) and, consequently, may be declared void.

Further, pursuant to Argentine law, directors must act loyally towards the company and its shareholders, which includes the director's responsibility to perform its duties with the diligence of a "good businessman" and in the interest of the company. Any failure to comply with these standards results in directors' unlimited liability for the damages arising therefrom.

To be released from any such liability, the director must timely file written objections to the company's resolution that caused the damages, and, if applicable, give notice thereof to the company's statutory auditors or file proceedings for challenging the decision.

Therefore, although it is not specifically provided, if a guarantee is deemed out of the scope of the securing company's purpose, it might be understood as a breach of the director's duties and, consequently, the director would be deemed responsible for negligence.

2.3 Is lack of corporate power an issue?

Yes. Corporate power is required to grant guarantees and any guarantee granted without sufficient corporate power could trigger director liability, as explained above.

2.4 Are any governmental or other consents or filings, or other formalities (such as shareholder approval), required?

No governmental authorisation, consent or approval is required to grant a guarantee. However, it is advisable that the Board of Directors or the shareholders' meeting previously approves the transaction, particularly if the guarantee is for a significant amount considering the net worth of the guarantor and there is no specific provision in the by-laws of the guarantor. A unanimous approval through a shareholders' meeting is also advisable.

Also, if the security consists of a mortgage over real property located in a security zone (close to borders and other strategic zones), upon execution, transfer of land will require prior approval from the Security Zone Commission, unless the transferee is an Argentine individual.

In addition, third parties' consents and registration may be required for the assignment of agreements to a trust. As a general rule, since contracts involve both rights and obligations, the transfer of the obligations is not allowed unless the express consent of the counterparty is obtained (see questions 3.1 and 3.4).

2.5 Are net worth, solvency or similar limitations imposed on the amount of a guarantee?

As long as the company operates within its corporate purpose, as explained in question 2.1, Argentine law does not provide limitations on the amount of a guarantee; however, deduction of interest may be limited under certain thin capitalisation rules. Please refer to question 6.5.

2.6 Are there any exchange control or similar obstacles to enforcement of a guarantee?

Foreign exchange rules allow residents to make payments abroad without entering and settling the funds through the Argentine Foreign Exchange Market (the "FX Market"). Regardless of whether the funds are entered through the FX Market or not, the debt must be registered in the survey of debt issuance of external debt and liabilities established by Communique A 6401, as amended. Argentine foreign exchange rules do not affect a foreign lender's ability to exercise its rights against a foreign guarantor.

If the guarantee is established over a local asset and its enforcement implies the collection of Argentine Pesos, the foreign lender is able to purchase foreign currency for repatriation purposes. Also, proceeds obtained from a bankruptcy proceeding can be transferred abroad.

3 Collateral Security

3.1 What types of collateral are available to secure lending obligations?

In general terms, Argentine law recognises two kinds of guarantees: "personal" guarantees; and "asset-backed" guarantees.

"Personal" guarantees are granted by a person or a legal entity committing its property to assure the performance of one or more obligations of the debtor. Upon the debtor's default, the creditor may eventually take legal action over the debtor's property and the guarantor's property. This guarantee, unlike asset-backed guarantees, does not create a lien or a privilege in favour of the creditor.

"Asset-backed" guarantees are granted over a specific property owned by the guarantor. In this kind of guarantee, either the debtor or a third party may be the guarantor. Unlike personal guarantees, asset-backed guarantees grant the creditor (i) the rights of "persecution" and "preference" over the asset in question, which means that the creditor has the right to pursue the guarantor's property, even if the guarantor sells or transfers the property, and (ii) the right to execute the guarantee and receive the corresponding payment with preference over other creditors, even in the event of insolvency or bankruptcy of the debtor or the guarantor.

The most common guarantees are the following:

(a) Mortgage: The mortgage is the most frequently used security over immovable property. Also for certain movable property which has significant value, the law specifically demands the constitution of a mortgage instead of a pledge (i.e. airplanes). For further details, please refer to question 3.3.

(b) Pledge: A pledge may be constituted over movable property, including but not limited to: machinery; vehicles; patents; and trademarks. For further details please refer to question 3.3.

(c) Trust in Guarantee: A trust may secure both movable and immovable property for a maximum term of 30 years. Goods held in trust form an estate separate from that of the trustee and the trustor. Trusts must be registered with the appropriate public registry. Also, if the property given in trust is registered in a public registry, the relevant registry will record the property in the trustee's name. Therefore, they should not be affected by any individual or joint actions brought by the trustee's or trustor's creditors, except in the case of fraud. The beneficiary's creditors may exercise their rights over the proceeds of the goods held in trust and be subrogated to the beneficiary's rights.

Any individual or legal entity may be appointed as a trustee of an ordinary trust. Financial entities that solicit services to act as trustees must obtain prior authorisation to do so. Although there is no ruling on the issue, it is advisable that the trustee be a different person from the secured creditor (although there is no obstacle if the trustee is a controlled or controlling entity of the secured party).

(d) Security Assignments: Assets may also be assigned as security. One of the differences with a trust is that, in the case of security assignments, assigned assets are typically limited to rights or credits including, without limitation, receivables.

The creditor may demand payment of the credit to either the assignor or the debtor of the assigned credit. If the assignor pays the amounts owed, then the assigned credit should be assigned back to the assignor.

3.2 Is it possible to give asset security by means of a general security agreement or is an agreement required in relation to each type of asset? Briefly, what is the procedure?

Although it is not possible to execute a general security agreement, including different types of collateral securities, it is possible to execute a general agreement including more than one asset of the same type; for example, a pledge may include machinery and vehicles. In any case, the assets must be clearly identified in the security agreement.

In relation to the procedure, a security is executed by means of an agreement between parties, subject – in certain cases – to certain formalities. For example, mortgages must be made through public deeds.

Argentine law allows the pledge over an inventory of goods ("floating pledge"). Please refer to question 3.3.

3.3 Can collateral security be taken over real property (land), plant, machinery and equipment? Briefly, what is the procedure?

Collateral security can be taken over real property (mortgage) or over machinery and equipment (pledge).

a) Mortgage: A mortgage generally secures the principal amount, accrued interest, and other related expenses owed by the debtor. To be valid, the following conditions should be met:

(i) The mortgagor must own the property or properties to be mortgaged.

(ii) The mortgagor must have the capacity to transfer its assets.

(iii) In certain cases, prior consent of the spouse is required.

(iv) The mortgage must be granted over one or more specific properties and the maximum amount and the obligation secured must be certain and determined. Conditional, future or undetermined obligations are permitted to be secured, provided that a maximum amount of the guarantee is determined upon creation of the mortgage. Additionally, the mortgage over real property extends to: (i) all its accessories as long as they are attached to the principal property; (ii) the supervening improvements made to the property; and (iii) the asset's earned income (*frutos civiles y rentas*).

Mortgages must be executed in writing by means of a public deed, which must be registered with the Land Registry of the jurisdiction where the property is located to be valid *vis-à-vis* third parties.

A mortgage remains in full force and effect until all amounts secured have been paid or the mortgage is otherwise cancelled. The registration of a mortgage will automatically expire 20 years after the date upon which it was registered, unless renewed.

b) Pledges: The debts secured by a pledge can be conditional, future or undetermined, or otherwise uncertain in amount.

Pledges in Argentina are mainly governed by the Argentine Civil and Commercial Code, which came into force in August 1, 2015.

According to the provisions of the current legislation, there are two classes of pledges:

(i) "Unregistered Pledge": the pledged assets can be delivered to the creditor or placed in the custody of a third party. Upon default, the creditor may sell the pledged asset through a public auction. The distinction between Civil and Commercial Pledge adopted by both abrogated Civil and Commercial Codes was not embodied into the new Civil and Commercial Code. The New Code provides that parties may agree on the following: (i) that the creditor may obtain ownership of the asset for the estimated value of it, made at the time of maturity of the debt, as set by the expert appointed by the parties or designated by the judge at the request of the creditor; or (ii) by means of a special sales proceeding.

(ii) "Registered pledge": There are two types of registered pledges: the "fixed pledge", used for specified assets; and the "floating pledge", used for a certain inventory of goods, with no precise identification of the goods. A floating pledge allows for the replacement of the goods of the pledged inventory.

The registration of a fixed pledge involves the filing of the petition to the Pledge Registry of the jurisdiction in which the personal property is located.

The pledge agreement is legally binding between the parties from the date of execution. Upon registration, the agreement is effective *vis-à-vis* third parties. It is effective *vis-à-vis* third parties from the execution date if the petition to register the pledge is filed before the corresponding registry within 24 hours of its execution.

The registration of a pledge expires five years after the date on which it was registered, unless renewed. Once perfected, a pledge remains in full force and effect until all amounts secured have been fully paid or the pledge is otherwise cancelled.

The floating pledge may be created through a notarised private document, using the form provided by the Registry of Pledges for such purposes (a public deed is not required).

3.4 Can collateral security be taken over receivables? Briefly, what is the procedure? Are debtors required to be notified of the security?

Yes. Collateral security can be taken over receivables. In order to have effect *vis-à-vis* third parties, a private assignment agreement must be executed and the assigned debtor must be notified by a notary public.

Alternatively, a trust structure may be used. Please refer to question 3.1.

3.5 Can collateral security be taken over cash deposited in bank accounts? Briefly, what is the procedure?

Argentine law recognises the validity of a pledge over cash. In this case, the pledge has full effect upon delivery of the amounts pledged to the pledgee. These guarantees are not usual, though.

As for the procedure, please refer to question 3.3.

3.6 Can collateral security be taken over shares in companies incorporated in your jurisdiction? Are the shares in certificated form? Can such security validly be granted under a New York or English law-governed document? Briefly, what is the procedure?

Yes. To be valid, the shareholder must inform the company about the terms and conditions of the pledge and the Board of Directors must record the existence of the pledge (i) in the Registry of Shares Book, and (ii) with a notation at the back of the share certificate (unless the shares are not represented in titles – i.e. book-entry shares).

Pursuant to Argentine law, movable assets which are permanently situated in a place and are not intended to be moved to a different jurisdiction are governed by the rules of the place where they are located. Thus, a guarantee agreement over the shares of a local company must be governed by the rules of Argentina.

Parties in a loan agreement may freely agree on the law applicable to the contract (see question 7.1), but Argentine law must rule the content, conditions and effects of a security over the shares of the company.

3.7 Can security be taken over inventory? Briefly, what is the procedure?

Yes, under a "floating pledge". Please refer to question 3.3.

3.8 Can a company grant a security interest in order to secure its obligations (i) as a borrower under a credit facility, and (ii) as a guarantor of the obligations of other borrowers and/or guarantors of obligations under a credit facility (see below for questions relating to the giving of guarantees and financial assistance)?

(i) Yes, debtors may guarantee their own obligations. Please refer to questions 3.1 and 3.3 above.

(ii) Yes. It is a third party guarantee, different from the debtor. Please refer to questions 3.1 and 3.3 above.

3.9 What are the notarisation, registration, stamp duty and other fees (whether related to property value or otherwise) in relation to security over different types of assets?

Notarisation, registration and other fees vary depending on the jurisdiction in which the agreement is executed.

The following chart details the main costs applicable to different securities:

Security	Fees
Real Property (Mortgage)	Notary Fees: 1% of the principal amount. Stamp Tax: 1% of the economic value of the agreement in the City of Buenos Aires; 1.8% in other jurisdictions such as the Province of Buenos Aires. Registration Fees: AR$ 800.
Chattel Personal Property (Pledge)	Notary Fees: low depending on the characteristics of the pledge. Registration Fees: 1% to 2% of the guaranteed obligation. Stamp Tax: 1% of the economic value of the agreement in the City of Buenos Aires; 1.2% in other jurisdictions such as the Province of Buenos Aires.
Accounts Receivable/ Debt Securities	Notary Fees: low, depending on the characteristics of the security. Registration Fees: 0.2% of the guaranteed obligation. Stamp Tax: 1% of the economic value of the agreement in the City of Buenos Aires; 1.2% in other jurisdictions such as the Province of Buenos Aires.

3.10 Do the filing, notification or registration requirements in relation to security over different types of assets involve a significant amount of time or expense?

Registration before the applicable registry may take between approximately one and six months, depending on the type of assets involved.

As to expenses, please see the table in question 3.9.

3.11 Are any regulatory or similar consents required with respect to the creation of security?

There are no explicit statutory restrictions on the ability of Argentine companies to create pledges on their assets to secure *their own* obligations. However, certain limitations to, or special requirements on, the ability of an Argentine company to create pledges in its assets may be included in the by-laws of the company.

In addition, the by-laws may require express approval for the creation of any pledge on the assets of a company by its Board of Directors, in which case a resolution of the Board would be needed. In the absence of such requirement, the pledge may be created by any representative acting pursuant to an adequate power of attorney or, in the case of a corporation, by the president of the company.

3.12 If the borrowings to be secured are under a revolving credit facility, are there any special priority or other concerns?

No special priorities are provided for revolving credit facilities. In this kind of loan, careful drafting should be taken into account. The guarantee granted at execution of the agreement may secure the subsequent renewals of the loan.

3.13 Are there particular documentary or execution requirements (notarisation, execution under power of attorney, counterparts, deeds)?

For documentary requirements, please refer to question 3.3.

When a public deed is required, signing in counterparts, although not expressly prohibited, is not advisable since it could create certain issues in terms of proof.

4 Financial Assistance

4.1 Are there prohibitions or restrictions on the ability of a company to guarantee and/or give security to support borrowings incurred to finance or refinance the direct or indirect acquisition of: (a) shares of the company; (b) shares of any company which directly or indirectly owns shares in the company; or (c) shares in a sister subsidiary?

The limitations referred to above with respect to guarantees also apply here. In addition, there might be a tax impact related to a leverage buy-out operation.

It should be noted that Income Tax Law does not provide clear parameters to distinguish between "debt" and "capital". Guidelines can be found in the Income Tax Law and its Regulating Decree, when they require – for irrevocable contributions – that "in no case shall there accrue interest or any accessories for the contributor".

As explained in question 6.1, a borrower is able to deduct interest (for income tax purposes) as long as the expenses were incurred to generate taxable income.

The Argentine Tax Authority has challenged the deduction of interest in cases of a leverage buy-out to acquire shares of local companies. The Argentine Tax Authority considered that such expense is not necessary to obtain taxable income or to keep or maintain its source. In certain cases, the resolution of the Tax Authority was confirmed by the Tax Court. The matter is pending a final ruling from the Argentine Supreme Court.

5 Syndicated Lending/Agency/Trustee/Transfers

5.1 Will your jurisdiction recognise the role of an agent or trustee and allow the agent or trustee (rather than each lender acting separately) to enforce the loan documentation and collateral security and to apply the proceeds from the collateral to the claims of all the lenders?

In Argentina, the role of the agent or trustee is governed by the rules of contract. Therefore, the parties in a syndicated lending may freely determine the functions and powers of the agent; such powers might include calculating the due amount of principal and interest, calculating financial ratios, informing the compliance or defaults of the debtor's obligations under the agreement, and keeping and guarding the loan documentation.

With the passing of Law No. 27,440, the classic US-like structure of collateral agent, pursuant to which security interests are granted directly to the trustee for the benefit of the lenders, was recognised by Argentine Law. The Law states that the powers of the collateral agent must be indicated in the contract and that the same must act upon the instructions of the lenders. Since the approval of such Law there has been no practice on this matter.

5.2 If an agent or trustee is not recognised in your jurisdiction, is an alternative mechanism available to achieve the effect referred to above which would allow one party to enforce claims on behalf of all the lenders so that individual lenders do not need to enforce their security separately?

- The credits and the guarantee might be transferred to a trustee, who will be committed to enforcing the security if the debtor fails to comply with the agreement and applying the proceeds from the security among the grantors-beneficiaries.
- A real property might be transferred to a trustee, who might constitute a guarantee trust over such property in favour of the creditors.
- The guarantee might be granted in favour of one creditor, who commits to act as a collateral agent based on an intercreditor agreement.

5.3 Assume a loan is made to a company organised under the laws of your jurisdiction and guaranteed by a guarantor organised under the laws of your jurisdiction. If such loan is transferred by Lender A to Lender B, are there any special requirements necessary to make the loan and guarantee enforceable by Lender B?

The assignment of credits must be documented in an agreement. A debtor's intervention in the agreement is not required.

The enforceability of the credits by the new lender is subject to two requirements: (i) the transfer of the credit; and (ii) the debt being payable.

Debtors should be given notarised notice of the assignment to be effective *vis-à-vis* third parties and the debtor itself, in case of a judicial claim. The notice could also be made through a private instrument with an unequivocal date (*fecha cierta*).

In case of pledges over credits, the publication of a notice in the Official Gazette is enough to make it effective against third parties (including the debtor).

6 Withholding, Stamp and Other Taxes; Notarial and Other Costs

6.1 Are there any requirements to deduct or withhold tax from (a) interest payable on loans made to domestic or foreign lenders, or (b) the proceeds of a claim under a guarantee or the proceeds of enforcing security?

As a general rule, deduction is allowed only for expenses incurred to generate taxable income.

Interest is deductible for the borrower. Interest deduction is limited by thin capitalisation rules (see question 6.5), unless a Double Tax Treaty with a non-discrimination clause is applicable. In such a case, total deduction could be possible. Recently, Law No. 27,430, which provides amendments to the Income Tax Law ("ITL"), was published. It establishes relevant modifications in the treatment of thin capitalisation rules. It also establishes that interest on financial debts – without including the debts generated by acquisitions of goods, leases or services related to the business line – incurred with individuals, residents or not, will be deductible up to the annual amount that establishes the Executive Power or up to the equivalent of 30% of the net income of the fiscal year that results before deducting both interest and amortisation, whichever is higher. Decree No. 1170/2018 established ARS 1,000,000 as the annual amount to compare.

Decree No. 1170/2018 provides some exceptions to the capitalisation rules if certain requirements are met.

The accumulated surplus in the three previous fiscal years may be added to this limit, as the amount of interest effectively deducted from the applicable limit is lower. The interest that could not have been deducted may be added to those corresponding to the following five fiscal years.

In addition, if the loan is made with a related party, with a party located in a low-tax jurisdiction or the funds do not arise from a low-tax jurisdiction (regardless if it is related or not), interest is deductible only when paid, and transfer-pricing rules apply. ITL, modified by Law No. 27,430, defines non-cooperative jurisdiction as any jurisdiction or country that: (i) has not signed an information exchange agreement with Argentina; (ii) has not signed a convention to avoid double taxation with Argentina; or (iii) has signed either agreement or convention but does not comply with its obligation to share information with Argentina. The Argentine Executive is responsible for issuing a list of non-cooperative jurisdictions.

6.2 What tax incentives or other incentives are provided preferentially to foreign lenders? What taxes apply to foreign lenders with respect to their loans, mortgages or other security documents, either for the purposes of effectiveness or registration?

There are no tax incentives for foreign lenders.

Foreign lenders will be taxed by income tax only on their profits from Argentina (Argentine-source income). When the lender is a banking or financial institution under the supervision of the relevant Central Bank or equivalent authority and is situated either in a jurisdiction that, in accordance with the regulations under the Income Tax Law, is not considered as a "low-tax jurisdiction", or in a jurisdiction that is party to an exchange of information treaty with Argentina and, as a result of the application of its internal regulations, cannot refuse to disclose information to Argentine authorities on the basis of bank or stock secrecy rules, the presumed net income in case of cross-border interest payments is 43% and, deriving from that, a 15.05% effective withholding rate. In all other cases of cross-border interest payments, the presumed net income is 100% and, therefore, the effective withholding rate is 35%. The Argentine debtor is responsible for the withholding and payment of the tax. Argentina has entered into treaties for the avoidance of double taxation with different countries. In certain cases, such treaties set forth ceilings to the effective withholding abovementioned. Value Added Tax ("VAT") applies to the sale of goods, the provision of services and the importation of goods and services. Under certain circumstances, services rendered outside Argentina, which are effectively used or exploited in Argentina, are subject to VAT.

Interest arising from a loan granted by a foreign entity is subject to VAT and the Argentine debtor is responsible for the payment of the tax.

The tax is levied on the interests paid and the current general rate is 21%. However, interests arising from loans granted by foreign banks are subject to a 10.5% rate when the central banks of their countries of incorporation have adopted the regulations provided by the Basel Committee.

Argentine Provinces and the City of Buenos Aires apply Turnover Tax (Tax on Gross Income), levied on gross income obtained from the exercise of onerous and habitual activity within each relevant jurisdiction. The tax rate varies in each jurisdiction.

For tax purposes, the activity of lending money is presumed to be carried out on a habitual basis, even if carried out once, and therefore is subject to Turnover Tax. The amount of returned capital is excluded from the taxable base. Thus, only the total amount of interest will be subject to Turnover Tax. Notwithstanding, it is not clear if interest collected by a foreign lender is subject to Turnover Tax.

Stamp Tax is a local tax levied on public or private instruments executed in Argentina, or documents executed abroad with effect in one or more relevant jurisdictions within Argentina. In general, this tax is calculated on the economic value of the agreement. Each jurisdiction applies different tax rates to different types of agreements, but the most common rate is 1%, e.g., the City of Buenos Aires. Certain ways of entering into contracts do not trigger this tax.

Finally, a tax imposed on credits and debits in bank accounts (the "TDC") must be paid in the case of credits and debits in Argentine bank accounts at a rate of 0.6%. However, the credit of the borrower in an Argentine bank account arising from the disbursement of principal of the loan would not be subject to the TDC since the disbursement of principal under a "banking loan" is exempt from the TDC.

6.3 Will any income of a foreign lender become taxable in your jurisdiction solely because of a loan to, or guarantee and/or grant of, security from a company in your jurisdiction?

Non-Argentine residents without a permanent establishment in Argentina are only subject to Income Tax on their Argentine-source income. Only income from Argentine sources will be taxed by Argentine Income Tax.

6.4 Will there be any other significant costs which would be incurred by foreign lenders in the grant of such loan/guarantee/security, such as notarial fees, etc.?

For notarisation, registration and other fees, please refer to question 3.9. In addition, the loan and the guarantees will generally be taxed by Stamp Tax. For the purposes of the Stamp Tax, the loan and the guarantees could be considered independently even if they were agreed in the same document. Then, the transaction might be doubly taxed in certain jurisdictions. However, in the City of Buenos Aires, for example, there is an exemption by which the guarantees are not subject to Stamp Tax if the main agreement has already paid the tax.

6.5 Are there any adverse consequences for a company that is a borrower (such as under thin capitalisation principles) if some or all of the lenders are organised under the laws of a jurisdiction other than your own? Please disregard withholding tax concerns for purposes of this question.

Under Argentine Income Tax Law (recently modified, please refer to question 6.1), thin capitalisation rules apply only to interest in respect of loans granted by resident-related or foreign-related institutions (located in or with funds that do not arise from jurisdictions which are not considered non-cooperative jurisdictions). It establishes that interest on financial debts – without including the debts generated by acquisitions of goods, leases or services related to the business line – incurred with individuals, residents or not, will be deductible up to the annual amount that establishes the Argentine Executive or up to the equivalent of 30% of the net income of the fiscal year that results before deducting both interest and amortisation, whichever is higher. Decree No. 1170/2018 established ARS 1,000,000 as the annual amount to compare. The accumulated surplus in the previous three fiscal years may be added to this limit, as the amount of interest effectively deducted from the applicable limit is lower. The interest that could not be deducted may be added to those corresponding to the following five fiscal years. This limitation will not apply if the recipient of the interest payments is a non-related party. Additionally, Decree No. 1170/2018 provides some exceptions to the capitalisation rules if certain requirements are met.

If the lender is located in a non-cooperative jurisdiction (regardless of whether it is related or not) or in a low-tax jurisdiction, interest is deductible only at the moment it is paid and transfer pricing rules apply.

7 Judicial Enforcement

7.1 Will the courts in your jurisdiction recognise a governing law in a contract that is the law of another jurisdiction (a "foreign governing law")? Will courts in your jurisdiction enforce a contract that has a foreign governing law?

Yes. Parties are able to choose the laws that will govern the agreement as long as some connection to the system of the chosen law exists. Further, foreign law will only be valid to the extent that it does not contravene Argentine international public policy (i.e. criminal, tax, labour and bankruptcy laws). Also, rights associated with real estate are governed exclusively by local laws.

7.2 Will the courts in your jurisdiction recognise and enforce a judgment given against a company in New York courts or English courts (a "foreign judgment") without re-examination of the merits of the case?

Yes. In principle, the courts of Argentina will recognise as valid and will enforce judgments of foreign courts if they refer to monetary transactions, subject to the compliance with certain procedural conditions (*exequatur*).

7.3 Assuming a company is in payment default under a loan agreement or a guarantee agreement and has no legal defence to payment, approximately how long would it take for a foreign lender to (a) assuming the answer to question 7.1 is yes, file a suit against the company in a court in your jurisdiction, obtain a judgment, and enforce the judgment against the assets of the company, and (b) assuming the answer to question 7.2 is yes, enforce a foreign judgment in a court in your jurisdiction against the assets of the company?

In Argentina, the length of litigation disputes depends on the complexity of the case and on whether appeals to court rulings are admitted.

Assuming the lender's creditor is unsecured, it might take between three and six years to obtain and enforce a final judgment. The render of a final decision might be delayed if foreign legislation governs the relationship between the parties.

Argentine procedural rules provide a fast-track proceeding called "exequatur" for the recognition and enforcement of a foreign judgment, which might last between one and three years. Exequatur proceedings do not require a re-examination of the merits of the case.

Despite the estimation above, freezing injunctions might be granted by Argentine courts if procedural requirements are met.

7.4 With respect to enforcing collateral security, are there any significant restrictions which may impact the timing and value of enforcement, such as (a) a requirement for a public auction, or (b) regulatory consents?

In principle, there are no restrictions in order to enforce collateral security. Nevertheless, if the guarantor does not comply with its obligations, the creditor would have to file a suit in court.

Please refer to questions 2.6 and 7.3.

7.5 Do restrictions apply to foreign lenders in the event of (a) filing suit against a company in your jurisdiction, or (b) foreclosure on collateral security?

In order to file a suit against a company in Argentina, the foreign lender must prove, if it is a company, that it is duly incorporated under the laws of its country.

7.6 Do the bankruptcy, reorganisation or similar laws in your jurisdiction provide for any kind of moratorium on enforcement of lender claims? If so, does the moratorium apply to the enforcement of collateral security?

The Bankruptcy Law does not provide any kind of moratorium on enforcement of lender claims.

Please refer to question 8.1.

7.7 Will the courts in your jurisdiction recognise and enforce an arbitral award given against the company without re-examination of the merits?

Yes. Arbitral tribunals are competent in monetary disputes. The enforcement of the arbitral award will be as equal as the enforcement of a judgment.

Arbitral tribunals may not solve cases in which Argentine tribunals have exclusive jurisdiction, nor when there is an express prohibition against arbitration (e.g. certain provincial matters).

8 Bankruptcy Proceedings

8.1 How does a bankruptcy proceeding in respect of a company affect the ability of a lender to enforce its rights as a secured party over the collateral security?

Bankruptcy and reorganisation ("*concurso preventivo*") proceedings in Argentina generally cause personal actions to mutate into credit verifications ("*verificación de créditos y privilegios*") within the proceeding. All creditors with credits with cause or title prior to the debtor's petition for reorganisation proceedings, or a court's declaration of bankruptcy, must file their credit verification requests with the bankruptcy/reorganisation proceeding court.

Although the creditor does not have to wait until the credit filing procedure is finished before requesting the liquidation of the asset, the court will perform a summary examination of the documentation evidencing the creditor's preference and request the opinion of the trustee before carrying out the liquidation of the asset. During the reorganisation proceeding, security interest claims with respect to real guarantees must continue its procedure before the court where they were initiated, provided that the creditors first verify their credits with the reorganisation proceeding's court.

Also, in the case of reorganisations, the court may, in the event of evident urgency or need, order the suspension for 90 days of any auction of property subject to a mortgage or a pledge ordered by any other judge.

A credit with a special preference has priority over credits with general preferences and unsecured credits. However, the recognition of these credits must be verified and accepted by the court, as explained in question 7.6.

Credits with special preferences will have priority on a specific asset, such as mortgages and pledges. This kind of preference can be enforced exclusively on the relevant assets and up to the proceeds of the liquidation of such asset.

8.2 Are there any preference periods, clawback rights or other preferential creditors' rights (e.g., tax debts, employees' claims) with respect to the security?

The court may determine a preference period of up to two years prior to the bankruptcy proceedings, depending on the date when insolvency was first evidenced.

Certain acts which occur during that preference period may be ineffective, such as: acts for which no consideration is given; debts paid prior to its maturity; and security interests obtained for a debt which is un-matured and which was originally unsecured.

There are two types of preferences:

(i) Special preferences, which are granted exclusively over certain specific assets of the debtor, e.g.: securities over the proceeds from the sale of the secured asset; expenses related to the assets that continue to be in debtor's possession; and salaries, etc.

(ii) General preferences, which are granted over all of the debtor's assets, e.g.: labour credits not subject to a special preference; social security debts; and certain personal expenses (such as funeral or medical costs), etc.

8.3 Are there any entities that are excluded from bankruptcy proceedings and, if so, what is the applicable legislation?

Yes. Among others, insurance companies, cooperative associations and public entities, such as the Nation, Provinces and Municipalities, the Catholic Church and embassies.

Financial institutions are, with a few exceptions, subject to general bankruptcy law. However, the Argentine Central Bank's cancellation of their banking licence is required, and they may not voluntarily enter into a reorganisation or bankruptcy proceeding.

8.4 Are there any processes other than court proceedings that are available to a creditor to seize the assets of a company in an enforcement?

Yes. The debtor may enter into out-of-court agreements with all or some of the creditors. A certain majority of unsecured creditors is required.

These agreements imply a debt restructure and are enforceable against all the unsecured creditors who executed it, including those that did not approve its content or voted against it.

To be enforceable against all unsecured creditors, the out-of-court agreement must be endorsed or validated by a competent court. Companies that are regulated by special insolvency rules (e.g., banks and insurance companies) cannot enter into this kind of proceeding.

9 Jurisdiction and Waiver of Immunity

9.1 Is a party's submission to a foreign jurisdiction legally binding and enforceable under the laws of your jurisdiction?

In principle, Argentine law allows parties of an international contract to submit to a foreign jurisdiction in matters of an economic nature.

9.2 Is a party's waiver of sovereign immunity legally binding and enforceable under the laws of your jurisdiction?

Yes. The waiver of sovereign immunity is valid under Argentine law (it should be expressly provided in the underlying agreement).

10 Licensing

10.1 What are the licensing and other eligibility requirements in your jurisdiction for lenders to a company in your jurisdiction, if any? Are these licensing and eligibility requirements different for a "foreign" lender (i.e. a lender that is not located in your jurisdiction)? In connection with any such requirements, is a distinction made under the laws of your jurisdiction between a lender that is a bank *versus* a lender that is a non-bank? If there are such requirements in your jurisdiction, what are the consequences for a lender that has not satisfied such requirements but has nonetheless made a loan to a company in your jurisdiction? What are the licensing and other eligibility requirements in your jurisdiction for an agent under a syndicated facility for lenders to a company in your jurisdiction?

There are no eligibility requirements in Argentina for lenders, agents or security agents, whether they are residents or foreigners, from the licensing perspective. A loan may be granted by, and the agent may be, an individual, a company, a bank, or any other entity.

In the case of loans granted by banks, the role of an agent is generally performed by a financial entity.

In principle, lenders do not need to be licensed or authorised to grant loans, provided that the financing activity is not performed on a regular basis. Otherwise, certain corporate and regulatory issues should be considered.

From a corporate standpoint, foreign companies are able to perform isolated acts in Argentina but if they want to perform their activities on a regular basis, a branch or a subsidiary must be established. For such purpose, foreign companies must: (i) evidence before the Public Registry the existence of the company; (ii) establish a domicile in Argentina; and (iii) justify the decision of establishing such branch or subsidiary, and appoint a legal representative.

From a regulatory perspective, if the activities performed by the lender fall under "financial intermediation" (intermediation between the supply and demand of financial resources on a regular basis), prior authorisation of the Argentine Central Bank is required. An activity is deemed financial intermediation if it combines both raising local or foreign funds and granting financing to third parties with such funds.

The activity in Argentina of the subsidiaries or representation offices of foreign financial entities is subject to regulation by the Argentine Central Bank, who will grant the required authorisation subject to the analysis of the backgrounds and responsibility of the foreign entity and its local office.

11 Other Matters

11.1 Are there any other material considerations which should be taken into account by lenders when participating in financings in your jurisdiction?

There are no other material considerations which should be taken into account.

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In recent years, he has been handling complex M&A transactions, including the investment by GE in YPF Energía Eléctrica; in real estate he advised on the investment by Goldman Sachs and Equity International in Pegasus Real Estate.

Diego also worked as foreign associate at Cleary, Gottlieb, Steen & Hamilton, in New York, between 2004 and 2005.

He graduated as a lawyer from the Universidad Católica Argentina (2001, *cum laude*), holds a Master's in Law from Columbia University School of Law, New York (2004) and a Master's in Finance from Universidad del CEMA (2007). Since 2011, he has taught contracts and business law at the Universidad de San Andrés.

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Marval, O'Farrell & Mairal is the largest law firm in Argentina and a market leader at both local and Latin American levels. With over 300 lawyers, the firm has been providing sophisticated, high-quality advice to international and local clients for over 95 years on international business issues and the complexities of cross-border transactions. Marval is in the general practice of law including: Banking and Finance; Capital Markets; Project Finance; Commercial and Competition Law; Corporate Law; Foreign Investments; Mergers and Acquisitions; Real Estate and Construction Law; Administrative Law; Entertainment and Media; Environmental Law; Insurance Law; Intellectual Property; Internet and Information Technology; Natural Resources; Utilities and Energy Law; Tax and Customs Law; and Telecommunications and Broadcasting. The firm ranks at the top of major legal publications and has been awarded with many international awards. *Chambers & Partners* recently recognised Marval as "Argentina Law Firm of the Year 2018".

Australia

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1 Overview

1.1 What are the main trends/significant developments in the lending markets in your jurisdiction?

Like the previous year, 2018 was a strong year for borrowers and for Australian bank and debt capital markets generally.

We saw a higher than usual number of "jumbo" transactions during the year (including financing for a Transurban-led consortium's $9.3 billion bid for Westconnex and Brookfield's $4.5 billion bid for Healthscope), demonstrating the depth of the Australian syndicated debt markets.

Debt funds continued their emergence as significant players, which has driven better pricing and terms for borrowers across the market. Financing options also continued to diversify, particularly on more highly leveraged transactions with a number of unitranche financings (such as acquisition financing for Greencross and Junior Adventure Group and refinancings for Only About Children and Findex) and Term Loan Bs with an AUD tranche (such as Leap Legal/Infotrack, Genesis Care and KKR's acquisition financing for MYOB) during the year. While traditional senior/senior + holdco mezzanine leveraged loans continue to be used, some of the larger sponsors are now running dual-track financing strategies, making banks as providers of traditional syndicated loans compete with unitranche financings or Term Loan Bs provided by institutional lenders/debt funds.

Finally, on the legal front, new "*ipso facto*" reforms (which impact the ability of counterparties to act on certain insolvency related events) commenced on 1 July 2018, which has wide-ranging implications on lending transactions.

1.2 What are some significant lending transactions that have taken place in your jurisdiction in recent years?

- Various bridge and refinancing transactions to support Sydney Transport Partners' (consortium comprising Transurban, CPPIB, AustralianSuper and Tawreed Investments Limited) winning $9.3 billion bid to acquire a 51% equity stake in Westconnex from the NSW Government.
- Macquarie Group Limited's £2.1 billion loan facility including £500 million in green tranches, being the first financial institution globally, and the first Australian company, to issue a green loan under APLMA Green Loan Principles.
- Infigen Energy's $605m refinancing, which saw Goldman Sachs underwrite the term loan tranche alongside a self-arranged super-senior revolving credit facility provided by CBA, Westpac and Goldman Sachs. The structure innovatively utilised intercreditor principles from unitranche/super senior revolver deals in the leveraged finance market.

KWM was involved in all the above transactions.

2 Guarantees

2.1 Can a company guarantee borrowings of one or more other members of its corporate group (see below for questions relating to fraudulent transfer/financial assistance)?

Yes. However, corporate benefit and other requirements need to be considered. These issues are outlined below.

2.2 Are there enforceability or other concerns (such as director liability) if only a disproportionately small (or no) benefit to the guaranteeing/securing company can be shown?

The directors of a company owe a duty to the company to act for the benefit of the company in its best interests, with due care and diligence, in good faith and for a proper purpose. Directors must also avoid any conflict between a director's duty to the company and that director's personal interest. Directors must comply with these duties when resolving to give a guarantee.

In determining whether to grant a guarantee or provide security, directors may consider both direct benefits and indirect benefits of doing so. Indirect benefits may include that the provision of the guarantee is a requirement for the ongoing support of other members of the corporate group where the support also indirectly benefits the company. While it is not sufficient that the guarantee benefits the corporate group as a whole, a director of a wholly owned subsidiary may take into account the best interests of its holding company as long as the constitution of the company permits it to do so and the company is solvent at all relevant times.

A guarantee that does not commercially benefit a company may be voidable and, in a liquidation, the guarantee could be deemed an uncommercial transaction or unfair preference. A breach of duties by directors can result in civil and criminal penalties and personal liability for directors.

2.3 Is lack of corporate power an issue?

An Australian company has all the powers of an individual. This includes the power to give a guarantee. However those powers may be limited by the company's constitution.

Third parties dealing with a company are entitled to make certain statutory assumptions, including that the company's constitution has been complied with unless they know or suspect the assumption to be incorrect.

2.4 Are any governmental or other consents or filings, or other formalities (such as shareholder approval), required?

Shareholder approval is not strictly required except for public companies in connection with related party transactions, subject to certain exemptions, the most relevant being where the transaction is on arm's-length terms or is for the benefit of 100%-owned subsidiaries. For private companies, it remains good practice to get shareholders' approval.

If the provision of a guarantee constitutes financial assistance, such as a guarantee of a loan used to assist the acquisition of shares in the company, the financial assistance must either (a) not materially prejudice the interests of the company or its shareholders or the company's ability to pay its creditors, (b) be approved by shareholders and the shareholders of relevant holding companies, or (c) fit within another exception.

Transactions which involve consumers and small business are subject to additional requirements under national consumer protection legislation.

2.5 Are net worth, solvency or similar limitations imposed on the amount of a guarantee?

There are no specific requirements of this nature that apply in addition to the corporate benefit requirements outlined above. However, guarantees given while a company is insolvent/nearly insolvent or which render a company insolvent can be set aside by a liquidator. Directors may also be subject to personal and criminal liability for entering into such guarantees.

2.6 Are there any exchange control or similar obstacles to enforcement of a guarantee?

There are no exchange controls that would prevent payment under a guarantee or restrict enforcement of a guarantee. However, Australian sanctions laws prohibit dealings with designated persons and entities in various countries.

3 Collateral Security

3.1 What types of collateral are available to secure lending obligations?

Most assets are available to secure lending obligations, subject to applicable contractual restrictions and, in limited cases, statutory restrictions. The regimes which apply to taking security differ according to whether the collateral is "personal property", in which case the *Personal Property Securities Act 2009* (Cth) ("**PPSA**") applies, or whether the collateral is real property, in which case State and Territory-based real property legislation applies.

The PPSA is modelled on the Canadian and New Zealand Acts and shares similarities with Art. 9 of the Uniform Commercial Code. Generally speaking, security interests are interests in personal property that in substance secure payment or performance and include some "deemed security interests" (such as certain leases of personal property and assignments of certain receivables) which may not secure payment or performance.

3.2 Is it possible to give asset security by means of a general security agreement or is an agreement required in relation to each type of asset? Briefly, what is the procedure?

Yes. A general security agreement ("**GSA**") granting general security over all or substantially all of the present and future assets of the grantor is routinely entered into. It is also possible to take security over one or more types of specific assets under a specific security agreement ("**SSA**") (e.g. shares in a company, book debts, deposit accounts, goods). Otherwise, it is not usual to provide for security over different collateral classes in separate documents.

A GSA will typically cover all real and personal property. However, if the collateral is land and the land is material to the security package, separate real property mortgages are also usually entered into and registered on the appropriate real property register for priority perfection purposes.

The PPSA provides for perfection of a security interest in personal property by one of three means:

- registration on the Personal Property Securities Register ("**PPSR**") – this is the most common method of perfection;
- in the case of goods and certain intangible rights, possession by the secured party; or
- in the case of certain financial assets (including shares and bonds), control by the secured party.

It is not mandatory to perfect security interests governed by the PPSA, but if they are not perfected, then:

- they vest in the grantor immediately upon the grantor being wound up or entering into voluntary administration, a deed of company arrangement or bankruptcy;
- a competing secured party may have a higher priority interest; and/or
- third parties may acquire an interest in the collateral free of the secured party's interest.

Australian law recognises fixed charges (or, using PPSA terminology, security interests over "non-circulating assets") and floating charges (security interests over "circulating assets").

3.3 Can collateral security be taken over real property (land), plant, machinery and equipment? Briefly, what is the procedure?

Yes.

Security over interests in land typically takes the form of a registered mortgage. Separate State and Territory laws regulate interests in land including real property mortgages and set out the applicable registration procedure. In certain States (including NSW and Victoria), subject to limited exceptions, registration of a real property mortgage must take place on PEXA (currently the only national electronic conveyancing platform).

Security over plant, machinery and equipment is usually taken under a GSA or SSA. Since plant, machinery and equipment (as long as they are not fixtures attached to land) are personal property, security over them is registrable on the PPSR.

3.4 Can collateral security be taken over receivables? Briefly, what is the procedure? Are debtors required to be notified of the security?

Yes.

Security over receivables can be taken under a GSA or an SSA.

If a "fixed charge" over receivables is required, the secured party must control dealings by the grantor with the receivables and register that it has control.

There is no requirement to notify the debtor in order to perfect the security interest or to obtain priority over other security interests. However, the secured party may wish to do so to obtain legal title to the receivables and the legal right to enforce in its name and power to give a good discharge.

3.5 Can collateral security be taken over cash deposited in bank accounts? Briefly, what is the procedure?

Yes.

Security over accounts with a bank or an approved deposit-taking institution (an "**ADI**") can be taken under a GSA or an SSA.

An ADI with a security interest in an ADI account held with it is taken to have perfected its security interest by control and need not take any other steps to perfect its security interest in that account. However, registration enables the ADI to perfect a security interest in any proceeds of the ADI account. Any other person who takes a security interest in an ADI account can only perfect their security interest by registration on the PPSR.

If a "fixed charge" is required over a bank account or ADI account, the secured party must control dealings by the grantor with the account and register that it has control.

3.6 Can collateral security be taken over shares in companies incorporated in your jurisdiction? Are the shares in certificated form? Can such security validly be granted under a New York or English law governed document? Briefly, what is the procedure?

Yes.

Security over shares in a company can be taken under a GSA or an SSA.

Shares in unlisted Australian companies are generally certificated. It is market practice in Australia that security over certificated shares is perfected by control (i.e. secured party holding share certificates and blank share transfer forms) as well as by registration on the PPSR.

Shares in listed Australian companies are uncertificated and are recorded on an electronic register. They are transferred in accordance with Australian Securities Exchange rules. In addition to registration on the PPSR, control is obtained by the secured party entering into an agreement with a "controlling participant" to regulate dealings with the shares in the clearing system.

Even though an English or New York law-governed document can create valid security over shares in an Australian company, an Australian law-governed GSA or SSA is the preferred technique used in practice, given Australian law is likely to govern the validity and perfection of the security under conflicts of law rules in the PPSA and at general law.

3.7 Can security be taken over inventory? Briefly, what is the procedure?

Yes.

Security over inventory can be taken under a GSA or an SSA.

If a "fixed charge" over inventory is required, the secured party must control dealings by the grantor with the inventory and register that it has control.

It is not usual for a secured party to take control over inventory as the grantor will need the freedom to deal with it in the ordinary course of business.

3.8 Can a company grant a security interest in order to secure its obligations (i) as a borrower under a credit facility, and (ii) as a guarantor of the obligations of other borrowers and/or guarantors of obligations under a credit facility (see below for questions relating to the giving of guarantees and financial assistance)?

Yes. This is subject to corporate benefit, financial assistance requirements and other issues mentioned in this paper.

3.9 What are the notarisation, registration, stamp duty and other fees (whether related to property value or otherwise) in relation to security over different types of assets?

Notarisation is not required under Australian law. The duty and fees associated with taking security in Australia are registration fees.

The fees for registering a security interest on the PPSR are nominal. Such registration can be made for seven years, 25 years or no stated end time.

The fees for registering a real property mortgage vary between States and Territories, but are similarly nominal, other than in South Australia and Queensland. Real property mortgages registered via the national electronic conveyancing platform will also be subject to a nominal fee in addition to statutory lodgement fees charged by each jurisdiction's land registry.

3.10 Do the filing, notification or registration requirements in relation to security over different types of assets involve a significant amount of time or expense?

No. There is no significant time or expense, and registrations on the PPSR are instantaneous. However, the PPSR registration system is highly prescriptive and invalidating errors are easy to make so care needs to be taken to ensure that registrations are correctly made.

3.11 Are any regulatory or similar consents required with respect to the creation of security?

Foreign lenders and foreign beneficiaries of security over Australian assets may need to consider the application of the Australian Government's Foreign Investment legislation, which is administered by the Foreign Investment Review Board ("**FIRB**"). Under some circumstances, notification and FIRB approval is required before taking or enforcing security.

In general terms, if security over Australian assets is held in the ordinary course of carrying on a business of lending money and solely as security for the purposes of a moneylending agreement, then a moneylender exemption will usually apply. The moneylender exemption also covers the acquisition of an interest by way of enforcement of a security held solely for the purposes of a moneylending agreement. Where the exemption applies, notification and FIRB approval is not required when taking or enforcing the security.

A "moneylending agreement" is defined to mean:

(a) an agreement entered into in good faith, on ordinary commercial terms and in the ordinary course of carrying on a business (a moneylending business) of lending money or otherwise providing financial accommodation, except an agreement dealing with any matter unrelated to the carrying on of that business; and

(b) for a person carrying on a moneylending business, or a subsidiary or holding entity of a person carrying on a moneylending business – an agreement to acquire an interest arising from a moneylending agreement (within the meaning of paragraph (a)).

For foreign government investors, the moneylender exemption requires that if an interest is acquired by way of enforcement of a security, that interest is disposed of (or a genuine sale process is commenced) within six months of the acquisition (or 12 months for an ADI), otherwise separate FIRB approval is required.

A foreign government investor includes a body politic of a foreign country, foreign governments, their agencies or related entities from a single foreign country that have an aggregate interest (direct or indirect) of 20% or more in the entity (or 40% or more if from multiple foreign countries), or if the entity is otherwise controlled by foreign governments, their agencies or related entities, and any associates, or could be controlled by them including as part of a controlling group.

A secured party may have reporting obligations under the recently enacted *Security of Critical Infrastructure Act 2018* (Cth) if security is taken over a 'critical infrastructure asset' (which includes certain ports, electricity, gas and water assets). However, there is uncertainty on the scope of the application of this legislation to secured parties.

3.12 If the borrowings to be secured are under a revolving credit facility, are there any special priority or other concerns?

No. If the security taken is perfected (whether by registration, control or possession) there are no specific priority concerns just because the security secures a revolving credit facility.

3.13 Are there particular documentary or execution requirements (notarisation, execution under power of attorney, counterparts, deeds)?

Australian documentary and execution requirements are not particularly onerous. Notarisation is not required.

An Australian company will generally sign in accordance with s. 127 of the *Corporations Act 2001* (Cth) ("**Corporations Act**") (by two directors, a director and secretary, or the sole director and secretary) because certain assumptions as to corporate authority can be relied upon by the counterparty. However, it is also common for Australian companies to sign under a power of attorney.

The execution of deeds by some foreign companies can present some minor logistical issues to ensure that the execution is valid; however, these issues are generally broadly understood in the market.

4 Financial Assistance

4.1 Are there prohibitions or restrictions on the ability of a company to guarantee and/or give security to support borrowings incurred to finance or refinance the direct or indirect acquisition of: (a) shares of the company; (b) shares of any company which directly or indirectly owns shares in the company; or (c) shares in a sister subsidiary?

A company is prohibited from financially assisting the acquisition of its shares or shares in its holding company, other than as set out below. A breach of the financial assistance provisions will not affect the validity of the transaction but can lead to civil offences for persons involved in the contravention and may lead to criminal offences where the breach was dishonest.

(a) Shares of the company

A company can give financial assistance if it either: (a) does not materially prejudice the interests of the company or its shareholders or the company's ability to pay its creditors; or (b) the financial assistance is approved by shareholders and the shareholders of relevant holding companies. There are some other fact-specific exemptions. Approval by shareholders of a company (first company) and the shareholders of the ultimate Australian holding company of the first company is referred to as a "whitewash" procedure and is routinely sought unless it is clear that there is no material prejudice to the interests of the company, its shareholders or its ability to pay creditors. The procedure involves lodging the shareholder approval documents with the Australian Securities and Investment Commission ("**ASIC**"). A 14-day waiting period applies before the financial assistance can be given.

(b) Shares of any company which directly or indirectly owns shares in the company

The financial assistance provisions also apply in situations where the financial assistance relates to shares being acquired in a holding company of the company giving the financial assistance. A holding company is any company that holds more than 50% of the shares, possesses more than 50% of the voting rights or otherwise controls the company board.

(c) Shares in a sister subsidiary

The financial assistance prohibition does not apply to the acquisition of shares in sister subsidiaries.

5 Syndicated Lending/Agency/Trustee/Transfers

5.1 Will your jurisdiction recognise the role of an agent or trustee and allow the agent or trustee (rather than each lender acting separately) to enforce the loan documentation and collateral security and to apply the proceeds from the collateral to the claims of all the lenders?

The use of agents for lenders and security trustees in syndicated lending agreements is common market practice in Australia.

Lenders will typically appoint an agent to represent them (in a non-fiduciary capacity), to perform defined administrative duties, to liaise with the borrower and security providers and to coordinate the lender group.

In most cases, security for a syndicated loan is granted to a security trustee who is able to enforce the security at the direction of the lenders (or the agent for the lenders) and is required to distribute the proceeds of enforcement in accordance with the security trust deed.

5.2 If an agent or trustee is not recognised in your jurisdiction, is an alternative mechanism available to achieve the effect referred to above which would allow one party to enforce claims on behalf of all the lenders so that individual lenders do not need to enforce their security separately?

This is not applicable in Australia.

5.3 Assume a loan is made to a company organised under the laws of your jurisdiction and guaranteed by a guarantor organised under the laws of your jurisdiction. If such loan is transferred by Lender A to Lender B, are there any special requirements necessary to make the loan and guarantee enforceable by Lender B?

Transfer and substitution mechanics are typically documented in the facility agreement and security trust arrangements. They set out the agreed manner in which rights and obligations of an outgoing lender are assigned or novated to an incoming lender with the consent of all parties where required. Other than the specified documentary requirements (including obtaining necessary consents), nothing additional is required.

In some circumstances, depending on the location of the loan and security, stamp duty may be chargeable in connection with an assignment of a loan.

6 Withholding, Stamp and Other Taxes; Notarial and Other Costs

6.1 Are there any requirements to deduct or withhold tax from (a) interest payable on loans made to domestic or foreign lenders, or (b) the proceeds of a claim under a guarantee or the proceeds of enforcing security?

Australia levies interest withholding tax (“**IWT**”) on interest payments (which is broadly defined for these purposes and includes amounts in the nature of, or in substitution for, interest and certain other amounts) under debt interests made by an Australian borrower in Australia to an offshore lender, unless an exemption applies. The rate of IWT is 10% of the gross amount of interest paid.

Some common exemptions to this are:

- a lending that is an issuing of “debentures” (such as bonds and notes) or a “syndicated loan” which results from a public offer made in a particular manner; and
- the “financial institution” exemption which is contained in certain double tax treaties which the Australian government has with a number of countries.

Interest that is effectively connected with an Australian branch of a non-resident lender would be taxed in Australia on an assessment basis rather than a withholding tax basis.

It is currently unclear whether or not any payment by a guarantor under a guarantee on account of interest owing by the borrower would be subject to IWT. The better view is that such payments (other than interest paid on an overdue amount) do not constitute “interest” for IWT purposes, and, if so, would not be subject to IWT.

6.2 What tax incentives or other incentives are provided preferentially to foreign lenders? What taxes apply to foreign lenders with respect to their loans, mortgages or other security documents, either for the purposes of effectiveness or registration?

There are none in Australia.

6.3 Will any income of a foreign lender become taxable in your jurisdiction solely because of a loan to, or guarantee and/or grant of, security from a company in your jurisidiction?

In most cases, the entry by a foreign lender into a loan agreement with an Australian borrower or taking security over assets in Australia will not, of itself, subject the lender to income taxation in Australia. However, this will depend on the circumstances, including whether or not the lender conducts any other business or has any relevant presence in Australia.

6.4 Will there be any other significant costs which would be incurred by foreign lenders in the grant of such loan/guarantee/security, such as notarial fees, etc.?

None other than as discussed above.

6.5 Are there any adverse consequences for a company that is a borrower (such as under thin capitalisation principles) if some or all of the lenders are organised under the laws of a jurisdiction other than your own? Please disregard withholding tax concerns for purposes of this question.

Australia has thin capitalisation rules which restrict interest deductions if the amount of debt used to finance Australian operations exceeds specified limits subject to safe harbours including *de minimis* exemptions.

The thin capitalisation rules apply to all debt interests, including debt advanced by related and unrelated lenders, whether Australian or foreign and therefore are not restricted to debt advanced by a foreign lender.

Any cross-border debt financing into Australia must also comply with Australia’s transfer pricing rules. The parties should be dealing on an arm’s-length basis and the debt should be priced having regard to arm’s-length conditions.

7 Judicial Enforcement

7.1 Will the courts in your jurisdiction recognise a governing law in a contract that is the law of another jurisdiction (a “foreign governing law”)? Will courts in your jurisdiction enforce a contract that has a foreign governing law?

In Australia, parties to a contract are free to select the governing law of the contract. However, to be enforceable, the choice of law must be made in good faith and must not contravene public policy.

7.2 Will the courts in your jurisdiction recognise and enforce a judgment given against a company in New York courts or English courts (a "foreign judgment") without re-examination of the merits of the case?

England

Generally yes, subject to fulfilment of registration requirements.

Under the *Foreign Judgments Act 1992* (Cth) and related regulations, English judgments can be registered and take on the status of an Australian judgment, subject to satisfying the following requirements:

- the judgment needs to be a "money judgment". That is, it must be a judgment under which money is payable but not taxes or any other charge of a similar nature, or in respect of a fine or other penalty;
- the judgment must not be under appeal;
- the judgment must not be wholly satisfied;
- the judgment must be enforceable in England; and
- the application for registration must be within six years of the date of the English judgment.

New York

There is no reciprocal bilateral arrangement for recognition of judgments between Australia and the United States. The United States of America is not a prescribed country for the purposes of the *Foreign Judgements Act 1992* considered above. Instead, common law principles for recognition and enforcement of foreign judgments apply. To be enforceable at common law:

- the judgment must be final and conclusive;
- the New York court must have exercised its jurisdiction over the defendant;
- the defendant must have submitted (or be deemed to have submitted) to the jurisdiction of the New York court; and
- the judgment must be for a monetary sum although certain non-monetary judgments may be enforceable in equity.

The judgment creditor must commence proceedings in the relevant court (e.g. the New South Wales Supreme Court) for recognition. Once recognised, the judgment of the Australian court is then enforceable in the same way as any other Australian judgment.

The limitation period for a common law action to enforce a foreign judgment is determined by the relevant State and Territory law relating to limitation periods.

7.3 Assuming a company is in payment default under a loan agreement or a guarantee agreement and has no legal defence to payment, approximately how long would it take for a foreign lender to (a) assuming the answer to question 7.1 is yes, file a suit against the company in a court in your jurisdiction, obtain a judgment, and enforce the judgment against the assets of the company, and (b) assuming the answer to question 7.2 is yes, enforce a foreign judgment in a court in your jurisdiction against the assets of the company?

It is not possible to specify a typical timeframe to finalise enforcement against assets. The timetable will be subject to variables including the type and complexity of the claim, the exact nature of the enforcement process, whether a formal insolvency process or liquidation is involved and whether the borrower or guarantor is cooperative.

7.4 With respect to enforcing collateral security, are there any significant restrictions which may impact the timing and value of enforcement, such as (a) a requirement for a public auction, or (b) regulatory consents?

The process of enforcement will be governed by the terms of the security documents and loan agreements, the PPSA and the Corporations Act (including the recent *ipso facto* reforms where the company is subject to the insolvency and reconstruction procedures set out in Chapter 5 of the Corporations Act).

In most circumstances, no regulatory consents are required in order to enforce. However, as set out in question 3.11, FIRB approval may be an issue in limited circumstances.

Restrictions also apply to enforcing collateral security in the event of insolvency, dependent upon the type of insolvency proceedings undertaken. We discuss this in section 8 below.

A receiver appointed by creditors under a security document is subject to statutory duties. This includes an obligation to sell collateral at market value or, if market value is not known, at the best price reasonably obtainable. While this does not of itself require a public auction, in many circumstances, a public auction or other transparent sale process will be required in order to demonstrate that the receiver has complied with its duties. This may have timing implications for recovery depending on the nature of the assets involved.

7.5 Do restrictions apply to foreign lenders in the event of (a) filing suit against a company in your jurisdiction, or (b) foreclosure on collateral security?

Subject to our comments about FIRB in question 3.11, there are no restrictions which apply specifically to foreign lenders.

7.6 Do the bankruptcy, reorganisation or similar laws in your jurisdiction provide for any kind of moratorium on enforcement of lender claims? If so, does the moratorium apply to the enforcement of collateral security?

The *ipso facto* reforms commenced on 1 July 2018 and apply to contracts, agreements and arrangements entered into on or after 1 July 2018, to impose a stay on contractual counterparties of companies who become subject to any of the following procedures: administration; making an application for or implementing a scheme to avoid insolvent winding up; or substantial controllership. The stay will apply to express rights arising for the following reasons: (1) the company being subject to the procedure; (2) the company's financial position during the procedure; (3) a reason prescribed in the regulations relating to the company possibly being subject to the procedure or the company's financial position; or (4) a reason in substance contrary to the stay (an "anti-avoidance" style provision). The stay also applies to self-executing rights; i.e. rights that apply automatically without a party taking action.

Importantly, the stay will not apply to, among other things: (1) contracts, agreements or arrangements specified in the regulations, including certain international capital markets instruments such as syndicated loans and bonds and variations to pre-1 July 2018 arrangements; (2) enforcement rights of a person with a perfected security interest over the whole or substantially the whole of the company (a "**Substantial Chargee**") who enforces within 13 business days in the case of a company that is under administration or generally in the case of a company that is subject to a scheme or scheme application; (3) drawstops, i.e. a creditor is not forced to advance new money if it has rights subject to the stay; (4) contracts, agreements or arrangements entered during the procedure; (5) a right prescribed in the declarations, including a right to crystallise a circulating security interest, to levy default interest, to assign, to set-off; or (6) a right exercised with the consent of the administrator, scheme administrator receiver or liquidator, as the applicable officer, or a right if a court so orders.

Further, in administration, there is a moratorium which runs from the date an administrator is appointed. Administration can be commenced in a number of ways, including by the directors of the company or a Substantial Chargee.

The length of this moratorium period varies and the moratorium prohibits any enforcement proceedings being commenced against the company or in relation to its property. However, a Substantial Chargee can enforce its security interest during a decision period of 13 business days from notice of commencement of the administration. Other exceptions include enforcement with the administrators' consent or leave of the court.

While an Australian company is in liquidation, a person is prohibited from commencing or proceeding with civil proceedings except by leave of the court. This prohibition does not apply to a secured party's right to realise or otherwise deal with its perfected security interest.

See also question 8.1 below.

7.7 Will the courts in your jurisdiction recognise and enforce an arbitral award given against the company without re-examination of the merits?

Yes, an award made in an international arbitration with a seat in one of the Contracting States to the *United Nations Convention on the Recognition and Enforcement of Foreign Arbitral Awards (New York, 10 June 1958)* (the "**New York Convention**") will generally be recognised and enforced by Australian courts, as if the award were a judgment or order of that court. Australian courts will not re-examine the merits of the arbitral award.

There are limited grounds upon which the court may refuse to enforce the foreign award under Article V of the New York Convention (which largely relate to matters of procedural fairness, with the public policy exception being narrowly construed by Australian courts).

8 Bankruptcy Proceedings

8.1 How does a bankruptcy proceeding in respect of a company affect the ability of a lender to enforce its rights as a secured party over the collateral security?

This depends on the type of bankruptcy proceedings undertaken.

See also question 7.6 above.

8.2 Are there any preference periods, clawback rights or other preferential creditors' rights (e.g., tax debts, employees' claims) with respect to the security?

A liquidator can seek court orders to set aside certain transactions entered into or where steps were taken to give effect to the transaction in a period before the external administration (i.e. the "**hardening period**"). This may include making payments or granting security. In relation to security, the key "voidable transactions" are:

- uncommercial transactions – a transaction which was entered into by a company when it was insolvent or as a result of which the company becomes insolvent and which a reasonable person would not have entered into; and
- unfair preferences – where there is a shortfall in security, a transaction between an insolvent company and a creditor under which that creditor receives more for its unsecured debt than it would have in a winding up.

Below is a summary of the hardening periods:

Transaction	Not related party	Related parties
Unfair preference	6 months	4 years
Uncommercial transactions	2 years	4 years
Unreasonable director-related transactions	N/A	4 years
Obstruction of creditors' rights	10 years	
Unfair loan	Indefinite	

Security interests over circulating assets (including receivables, inventory and cash in bank accounts) which are not subject to control:

(a) may be void as against a liquidator if it was created within six months of the external administration and the company was insolvent, except insofar as it secures a new advance; and

(b) will rank in a winding up behind certain statutorily preferred creditors such as employee entitlements and administrator's and liquidator's indemnity for debts and remuneration.

Normal directors' duties also apply to a director's decision to grant security (see question 2.2 above), and if security has been granted in breach, secured lenders may be subject to clawback risk under concepts of knowing receipt/knowing assistance. The "hardening period" is six years or more.

8.3 Are there any entities that are excluded from bankruptcy proceedings and, if so, what is the applicable legislation?

No. However, banks, other ADIs and insurers are subject to different and specific insolvency regimes under legislation including the *Banking Act 1959* (Cth) and the *Insurance Act 1973* (Cth).

8.4 Are there any processes other than court proceedings that are available to a creditor to seize the assets of a company in an enforcement?

Yes. A secured party may enforce its security by appointing a receiver (or receiver and manager) or entering into possession as mortgagee in possession, subject to any moratoriums or restrictions on enforcement (see question 7.6 above).

Appointment and powers of a receiver or mortgagee in possession is governed by the terms of the security document. The PPSA also provides certain notice requirements which may apply to enforcement against personal property. In addition, the PPSA provides a range of statutory enforcement options – these do not apply where a privately appointed receiver or other controller is realising assets of a corporate borrower or guarantor, but do apply to other controllers. The PPSA provisions are, in many instances, contracted out of.

Where the relevant security is a real property mortgage, a secured party can also either appoint a receiver or enter into possession as mortgagee under the relevant State or Territory laws. A mortgagor can restrain the sale where it can be shown that the power of sale has not become exercisable or the mortgagee is in breach of the duty to sell.

Some statutes may provide other remedies as well.

9 Jurisdiction and Waiver of Immunity

9.1 Is a party's submission to a foreign jurisdiction legally binding and enforceable under the laws of your jurisdiction?

Yes. Under the *Foreign Judgments Act 1991* (Cth), a party's submission to a foreign jurisdiction is legally binding and enforceable in Australia provided that the subject matter is not illegal and not contrary to public policy.

9.2 Is a party's waiver of sovereign immunity legally binding and enforceable under the laws of your jurisdiction?

As a general rule, a party's waiver of sovereign immunity will be legally binding and enforceable under the *Foreign States Immunities Act 1985* (Cth).

10 Licensing

10.1 What are the licensing and other eligibility requirements in your jurisdiction for lenders to a company in your jurisdiction, if any? Are these licensing and eligibility requirements different for a "foreign" lender (i.e. a lender that is not located in your jurisdiction)? In connection with any such requirements, is a distinction made under the laws of your jurisdiction between a lender that is a bank *versus* a lender that is a non-bank? If there are such requirements in your jurisdiction, what are the consequences for a lender that has not satisfied such requirements but has nonetheless made a loan to a company in your jurisdiction? What are the licensing and other eligibility requirements in your jurisdiction for an agent under a syndicated facility for lenders to a company in your jurisdiction?

If a person provides a "financial service", it must obtain an Australian Financial Services Licence from ASIC under the Corporations Act and comply with a range of conduct obligations. Although loan facilities are excluded from the Corporations Act, issuing, acquiring or arranging a derivative, swap or deposit product will constitute a financial service, as will providing advice in connection with those products.

There are no licensing or registration requirements in Australia that apply specifically to entities that act as an agent or security trustee.

Approval is required from the Australian Prudential Regulation Authority ("**APRA**") before an entity (including a bank) carries on banking business in Australia. The use of the word "bank", "banking", "credit union" and related words when a company or bank carries on business in Australia is also restricted unless the company is registered as a bank or has approval from APRA.

In most cases, the making of a single loan in Australia or taking of security in Australia by any entity does not require the lender or secured party to be registered with ASIC as a foreign company. However, this is a complex issue that depends on the circumstances including the amount of business that the entity carries on in Australia and the presence that the entity has in Australia.

Registration and reporting requirements apply under the *Financial Sector (Collection of Data) Act 2001* (Cth) ("**FSCODA**") to lenders that make loans in the course of carrying on business in Australia. FSCODA no longer applies to foreign lenders that do not carry on business in Australia – however, this test must be considered with caution as Australian courts have recently given a wider meaning to "carrying on business in Australia".

Registration with the Australian Transaction Reports and Analysis Centre and compliance with the *Anti-Money Laundering and Counter-Terrorism Financing Act 2006* (Cth) will be required for loans made at or through the lender's (or its agent's) permanent establishment in Australia.

Breaches of applicable legislation may results in fines or penalties being imposed.

11 Other Matters

11.1 Are there any other material considerations which should be taken into account by lenders when participating in financings in your jurisdiction?

The issues outlined above provide a general overview of the main legal considerations which are most likely to be relevant to secured lenders in Australia.

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- oOh!Media Limited's acquisition/refinancing facilities to support their A$570 million bid for Adshel.
- Navis Capital's A$700 million+ acquisition of Device Technologies Australia.
- GenesisCare's covenant-lite A$875 million equivalent Euro and AUD Term Loan B debut issuance.

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- Livingbridge on its first Australian investment.
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- Sydney Airport on its debt facilities including on the Australian financing aspects of its recent €500 million issuance.
- The lead arranger on the financing of Coronado's A$700 million acquisition of Curragh Coal from Wesfarmers.

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- Best International Firm in China Practice, *Euromoney, 2018.*
- Corporate & Finance China Law Firm of the Year, *Chambers China Awards, 2019.*
- Banking and Finance China Firm of the Year, *Asian-Mena Counsel, 2018.*
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- Law Firm of the Year – *KangaNews Awards 2018* (12 consecutive years).
- Best Law Firm (revenue over $200m) AFR Client Choice 2018 (3 consecutive years) and Best Professional Services Firm (over $200m) *AFR Client Choice 2016* and *2018*.

Austria

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1 Overview

1.1 What are the main trends/significant developments in the lending markets in your jurisdiction?

Lending markets in Austria have continued to improve over the last few years as a result of the ongoing economic upturn; however, in 2018 this progress weakened more and more. Nevertheless, growth rates in Austria are still substantially above the European average and corporate loans especially have increased in 2018. Such rise is primarily attributable to real estate-related investments. Overall lending activity is dominated by the participation in Anglo-Saxon and German syndicated financing transactions.

Austrian credit institutes, like all European banks, continued to focus on their strategies concerning lending business in connection with increasing regulatory framework, such as regulations relating to the determination of risk-weighted assets and own funds. EBA (European Banking Authority) stress tests are growing in importance in this context.

Austrian credit institutions have also continued to deal with their fair share of non-performing loans, which kept the market on trading with such non-performing loans active.

The Act on the Recovery and Resolution of Banks (*Sanierungs- und Abwicklungsgesetz* (BaSAG), implementing the Bank Recovery and Resolution Directive 2014/59/EU (BRRD)) covers CRR credit institutions and CRR investment firms, including certain CRR financial institutions, financial holding companies and branches of third-country institutions to the extent they are part of a group of credit institutions. BaSAG, which came into effect on 1 January 2015, requires "recovery plans" to be drawn up by institutions to identify impediments and outline measures which could guarantee effective resolutions. The impact of this Act to the lending market might be described as having a confidence-building effect, in particular with respect to the syndicated loan market.

Additionally, particularly in syndicated loan scenarios, the Austrian Act on Financial Collateral (*Finanzsicherheiten-Gesetz* (FinSG)), which regulates the granting and enforcement of financial collateral arrangements between participants in the financial markets, is becoming more and more important. The FinSG provides for wider and less regulated means of enforcement of the collateral and, in particular, the FinSG provides for the option to agree on an immediate realisation of the collateral if an insolvency, liquidation, or reorganisation proceeding is opened against the collateral provider.

1.2 What are some significant lending transactions that have taken place in your jurisdiction in recent years?

One significant lending transaction in 2017 in Austria concerned AT&S Austria Technologie & Systemtechnik Aktiengesellschaft in connection with a hybrid bond with a total volume of EUR 175m. In 2016, STADA Arzneimittel AG issued a new promissory note to investors, whereby the volume amounted to EUR 350m at fixed as well as variable interest rates. German Vonovia made an offer to take over the Austrian Buwog-Group, a publicly owned real estate holding, for EUR 5.2 billion. Some lending transactions also made use of new technologies. One of those lending transaction in 2018 concerned ASFINAG (*Autobahnen- und Schnellstraßen-Finanzierungs-Aktiengesellschaft*) and Erste Group Bank AG in connection with a promissory note using blockchain technology, and Verbund AG placed a green promissory note via digital emission in the first quarter of 2018, it being reported that Vonovia's take-over is to a great extent debt financed. Austrian infrastructure projects are frequently also subject to public financings which are usually linked to loans or guarantees issued by credit institutions. One major loan of that type was the European Investment Bank's EUR 400m financing of the Vienna Airport passenger terminal, with the involvement of Austrian credit institutions as guarantors. It is noteworthy to mention that there is also a general trend in the Austrian lending market to scrutinise long-term loans in terms of agreed interest *versus* market interest.

2 Guarantees

2.1 Can a company guarantee borrowings of one or more other members of its corporate group (see below for questions relating to fraudulent transfer/financial assistance)?

Austrian law does not restrict downstream guarantees (or other security) *per se*. However, there are stringent limitations, which apply to upstream and side-stream guarantees provided by corporations (and equivalent entities).

As a basic principle, distributions to (direct or indirect) shareholders of a corporation (AG, GmbH, GmbH & Co KG, i.e., a limited partnership in which the only unlimited partner is a GmbH) may only be effected under specific circumstances, namely (a) in the form of formal dividend distributions based on a shareholders' resolution, (b) in the case of a capital decrease (which also requires a shareholders' resolution), or (c) in the form of a distribution of liquidation surplus. Besides that, it is recognised that a company and its shareholders may enter into transactions with each other on arm's-length terms and conditions. This requirement entails that the management of the company makes – prior to entering into such a transaction – a comprehensive assessment of a proposed transaction, in particular of the risks involved, and shall only enter into such transactions with its (direct or indirect shareholder or a sister company) if and to the extent that it would enter into the transaction on identical terms and conditions with any unrelated third party. However, the management must not enter into a transaction, if by any such transaction the existence of the company would be threatened.

To some extent, Austrian law jurisprudence also accepts specific corporate benefits as an adequate means of justification for granting upstream and side-stream guarantees. Requirements for such corporate benefit are that the corporate benefit must not be disproportionate to the risk and that the corporate benefit must be specific and not only a general corporate benefit, such as a general "group benefit".

Austrian case law on these restrictions is based on a case-by-case evaluation and has become increasingly stringent over the last 20 years. In practice, it is advisable to have the management of the company assess the proposed transaction in accordance with the above criteria. Potential consequences of a breach of these Austrian capital maintenance rules include personal liability of the management as well as nullity of the respective transaction.

The above principles do not only apply in respect to funds or loans paid by a company but to all benefits granted by such company, including guarantees for borrowings.

2.2 Are there enforceability or other concerns (such as director liability) if only a disproportionately small (or no) benefit to the guaranteeing/securing company can be shown?

As discussed in question 2.1, a violation of the stringent capital maintenance rules will have the result of the transaction being void. Only if transactions are *per se* (economically and as per the assumed intention of the parties, if they reasonably would also have entered into the remaining part of the transaction) dividable into separate parts, then Austrian jurisprudence holds that the violation of capital maintenance rules shall render the transaction only partially void. Whether any such transaction (e.g. a guarantee) would be found by any competent court to be only partially or entirely void is decided on a case-by-case basis, which therefore causes tremendous risks on the predictability of such type of transaction.

Shareholders and managing directors of corporations may be held personally liable for damages, if capital maintenance rules are violated. The provision of a guarantee/security for only a disproportionately small (or no) benefit would presumably constitute such a violation. In case of a violation, managing directors are liable for their own culpable behaviour; i.e. if they did not act in accordance with the standard of care of a prudent businessman, provided that the directors' liability is in principle only towards the company, but not towards individual shareholders or creditors (although exceptions apply).

In order to mitigate the risks of nullity of a guarantee or personal liability of the management of the company providing the guarantee, it has become common practice in Austria to include limitation language, restricting the (potential) enforcement of upstream or cross-stream security arrangements to the maximum permissible extent under Austrian capital maintenance law. Since the validity of upstream or cross-stream guarantees needs to be subject to a case-by-case evaluation, any reliance on upstream or cross-stream guarantees and the according use of limitation language causes ambiguities and is likely to decrease the commercial value of such guarantees.

2.3 Is lack of corporate power an issue?

Austrian companies are generally not subject to the *ultra vires* doctrine. Internal restrictions, which may be based on organisational regulations or on internal approval procedures (e.g. if the supervisory board has to consent to a measure), are allowed and very common, but they generally have no effect on the validity of agreements with third parties. However, such internal restrictions may have to be observed if the third party was aware of the excess of corporate power by the corporations' representative and if the damage to the company resulting therefrom must have been obvious to such third party or if the management and the third party had acted collusively with the management to the company's detriment.

2.4 Are any governmental or other consents or filings, or other formalities (such as shareholder approval), required?

The Austrian Banking Act (*Bankwesengesetz*) requires a banking licence to be issued by the Austrian regulator (Financial Market Authority) for the lending business, i.e. the commercial providing of financing to borrowers. Notified licences of a credit institution domiciled in another European economic area (EEA) jurisdiction (based on the home Member State concept) will be held equivalent for that purpose. The same applies for the acquisition of (loan) receivables on a commercial basis (i.e., factoring) which, in principle, prevents work-around-structures, such as the disbursement of a loan by an Austrian "fronting bank" and immediate acquisition of the loan by a foreign, non-licensed lender. Insurance companies granting loans for the purposes of creating a reserved asset base for the purpose of their insured persons/customers are, *inter alia*, subject to some exceptions.

Limited exceptions also apply in the context of small-category financings such as crowd-funding which, in Austria, has only recently been regulated in statutory law and provides for exceptions from both the bank licence and capital markets' prospectus requirements, if and to the extent that a financing does not exceed certain thresholds.

Resolutions, such as shareholders' resolutions, are – as set out in question 2.3 – not a general requirement for the validity and enforceability for an act of the legal representative of an Austrian corporation (limitations may apply as set out in question 2.3). However, it is, especially with respect to larger/syndicated financings, standard market practice to obtain shareholder approvals for entering into a loan agreement, security agreement or other associated finance documents or to obtain capacity opinions, which will be based on the respective review of corporate resolutions.

2.5 Are net worth, solvency or similar limitations imposed on the amount of a guarantee?

Apart from general limitations in connection with capital maintenance rules (as discussed above) and customary contractual enforcement limitations, it shall be noted that guarantees, and the maximum amount owed under a guarantee, will be interpreted on a very strict basis and ambiguities in the wording of the guarantee may be interpreted by a court to the detriment of the beneficiary of the guarantee.

2.6 Are there any exchange control or similar obstacles to enforcement of a guarantee?

Under Austrian law, there are no such exchange controls which would pose obstacles to the enforcement of guarantees.

3 Collateral Security

3.1 What types of collateral are available to secure lending obligations?

In Austria, there are two general groups of collateral that may be used to secure lending obligations: personal collateral on the one hand; and *in rem* collateral on the other hand.

In respect to personal collaterals, (a) assumption of debt (*Schuldbeitritt*), (b) sureties (*Bürgschaften*), (c) guarantees, and (d) letters of comfort (*Patronatserklärungen*) are the most common types for securing lending obligations.

The most frequent *in rem* collaterals to be used are (a) pledge of assets (such as a pledge on movables or a mortgage), (b) transfer of title for security purposes (*Sicherungsübereignung*), (c) assignment for security purposes (*Sicherungszession*), and (d) retention of title (*Eigentumsvorbehalt*).

In general, the most common types of collateral are share pledges, mortgages, account pledges, assignment of current and future receivables, trademark and IP-right pledges, and sometimes the pledge on stock in warehouses (which, based on the very stringent law on perfection of pledges, basically requires that the pledgee takes control over the stock, and is extremely difficult to establish and maintain under Austrian law).

3.2 Is it possible to give asset security by means of a general security agreement or is an agreement required in relation to each type of asset? Briefly, what is the procedure?

The concept of a general security interest in all (current and future) assets of the pledgee to the assignee dose not exist under Austrian Law. As a result of the various different perfection requirements for different types of collateral under Austrian law (e.g. entry into the land register for mortgages, book entry for the assignment of claims as an alternative to the notification to third-party debtors, the notification of the company when pledging shares in an Austrian Limited Liability Company), but also for reasons of enhancing the enforceability of collateral even in case one category of collateral was not perfected or is not enforceable, it is standard market practice to have one security agreement for each class.

3.3 Can collateral security be taken over real property (land), plant, machinery and equipment? Briefly, what is the procedure?

Real property can be a security in the form of a pledge (mortgage). The pledge must be agreed upon between the pledger and the pledgee, where such pledge agreement does not require a specific form, but for perfection needs to be registered in the land register where the real property that is being pledged is located. When intending to accomplish the entry into the land register, the pledger of the property must provide a specific consent declaration in authenticated form regarding the registration (*Aufsandungserklärung*). Multiple pledges over one individual property are possible and will be ranked among each other in terms of priority (based on the point in time when the application for registration of the pledge in the land register reaches the competent land register; the court is decisive). There is also a possibility to establish a mortgage over more than one property by creating a simultaneous mortgage (*Simultanhypothek*).

Registration fees play a significant role in the registration of a pledge over real property in the land since they amount to 1.2% of the secured amount of the real property. In order to avoid such fees in some lending scenarios, the lender agrees to receive a registrable (i.e. authenticated) pledge agreement in combination with a ranking (*Rangordnungsbeschluss*), which insures for one year that no third party may enter another mortgage into the specific rank (which, however, due to the limited term of the ranking order, the 0.6% fee of the secured amount associated with the entry of such ranking order and the fact that the critical period of rescission under insolvency law will only start to run if the mortgage is registered, is in most lending scenarios not considered adequate).

A pledge of real estate generally also extends to any fixtures and accessories. Any equipment that is not connected to a real property in the sense of the preceding sentence is considered to be movable property. With regard to security agreements in respect of movables, no specific formal requirements must be observed. However, Austrian law imposes strict standards of perfection that either require a physical transfer of the pledged goods or any equivalent measure, such as handing over via declaration, in case the physical transfer would be too burdensome to be performed. The same strict perfection requirements are required in case of full title transfer of such goods for security purposes (in order to avoid circumvention).

Warehouse pledges are generally admissible under Austrian law as well, provided the stringent rules in respect of the perfection of the assets contained in the warehouse are observed, which basically requires signage of the goods and the appointment of a warehouse custodian, who shall be strictly bound by the instructions of the pledgee only and shall ensure that goods are only removed from the warehouse if so accepted by the pledgee.

3.4 Can collateral security be taken over receivables? Briefly, what is the procedure? Are debtors required to be notified of the security?

Security rights may be taken over receivables either by way of pledge or by way of full transfer of rights (for security purposes) via assignment.

Under Austrian law, in general, no more requirements than an agreement between the assignor and the assignee have to be fulfilled in order to take receivables as security. While not each and every claim has to be specifically identified, any receivable that is to be assigned must be sufficiently identifiable. If the respective receivables are recorded in the creditor's/assignor's books, it is mandatory that the pledge is annotated in both the list of obligors of the assignor and in the list of open accounts. Notifying third-party debtors, however, provides an alternative perfection procedure. Future receivables, if sufficiently identifiable, can also be subject to assignments (or pledges).

Receivables pledges and security transfers may also extend to future receivables or certain categories of receivables, if and to the extent that such receivables are duly described in the security agreement.

3.5 Can collateral security be taken over cash deposited in bank accounts? Briefly, what is the procedure?

Under Austrian law, collateral security may be taken over cash deposited in bank accounts. Such cash collateral is commonly established in the form of account pledges, which are not subject to any special form requirements and therefore in practice principally drawn up in simple written form. In order to become perfected, the bank that holds the respective account must be notified (in its capacity as the third-party debtor).

The commonly used general terms and conditions of Austrian banks provide for a general pledge over all funds of a bank's customer for any funds transferred by customers into custody of the bank (i.e. the funds of customers on bank accounts). This standard pledge agreement contained in the general terms and conditions is typically waived or subordinated if the funds on bank accounts are pledged for security purposes for a pledgee other than the bank holding the account. As of the date the pledge has been created, the owner has no access to the funds in the bank account and the respective garnishee must not pay out money from the pledged account to the owner.

3.6 Can collateral security be taken over shares in companies incorporated in your jurisdiction? Are the shares in certificated form? Can such security validly be granted under a New York or English law governed document? Briefly, what is the procedure?

Security rights over shares in a Limited Liability Company (*Gesellschaft mit beschränkter Haftung – GmbH*) are generally created by way of pledge. While the actual transfer of GmbH shares requires a notarial deed, a share pledge may be done in (simple) writing form. For the perfection of the GmbH share pledge, the notification of the company is required. In practice, share pledges are commonly made together with a power of attorney for the sale of the shares in case of an event of default by the pledgee, whereby such power of attorney needs to be executed by the pledgor in authenticated form to comply with the requirement that a power of attorney for the sale of shares in a GmbH has to be authenticated.

The pledge of shares of a Stock Corporation (*Aktiengesellschaft*) differs from the pledge of GmbH shares, as shares of an AG are typically certificated as securities, which is especially reflected in the different perfection requirements. In contrast to the GmbH, the sale of shares in AGs requires no specific form and thus, powers of attorney for the sale, if any, are not required to be authenticated.

Generally, the perfection of *in rem* securities over movables (such as certificated securities) requires that the pledgee obtains direct or indirect (e.g. via the account bank) possession in the shares. Only shares in stock-exchange listed companies may be certificated as bearer shares (*Inhaberaktien*). This is effected through a global share certificate with the shares then being introduced into an electronic clearing system. In such case, a pledge may be created by transferring the shares to the pledgee's securities deposit account or by blocking the pledgor's account in the pledgee's favour.

3.7 Can security be taken over inventory? Briefly, what is the procedure?

As set out in question 3.3, Austrian law imposes strict standards of perfection for all kinds of movables, including inventories, and either requires a physical transfer of the pledged goods to the pledgor (or its custodian) or any equivalent measure, such as handing over via declaration, in case the physical transfer would be too burdensome to be performed. In respect to inventory – as is the case with respect to general warehouse pledges – for perfection of the security, it will be necessary that the inventory is stored separately from all other goods of third parties and access to the inventory (and any release of inventory) is strictly observed – and subject to agreement by the pledgee – by a custodian of the pledgee.

3.8 Can a company grant a security interest in order to secure its obligations (i) as a borrower under a credit facility, and (ii) as a guarantor of the obligations of other borrowers and/or guarantors of obligations under a credit facility (see below for questions relating to the giving of guarantees and financial assistance)?

Subject to the limitations arising from the stringent capital maintenance rules under Austrian law, there are no general obstacles under Austrian law that a company may at the same time under one credit facility grant security for its own obligations as borrower under such credit facility and grant security (or guarantee) for the obligations of other obligors under such guarantee facility (which is, e.g., regularly the case if a holding company takes up the loan and guarantees as the borrower the obligations of all or certain of its direct and indirect subsidiaries).

3.9 What are the notarisation, registration, stamp duty and other fees (whether related to property value or otherwise) in relation to security over different types of assets?

Stamp duty is governed by the Stamp Duty Act (*Gebührengesetz*) and follows a strict civil approach, which is that stamp duty is levied on various legal transactions concluded in physical written form (but also electronically, such as via e-mail). Also, legal documents executed abroad can trigger stamp duty. Stamp duty is levied either when both parties to an agreement are Austrian residents or when the written document evidencing the transaction is brought to Austria in its original form or in the form of a notarised copy, provided that the legal transaction has legal effect in Austria; or a legal obligation is assumed under the legal document or will be performed in Austria. Furthermore, stamp duty may be also triggered if, based on a written document, another legal binding action occurs in Austria or if such document is used as evidence before the authorities or courts.

The Stamp Duty Act provides for a wide variety of documents that trigger stamp duty. Documents often used in connection with loan agreements include: sureties, which trigger a 1% stamp duty; assignment agreements, which trigger a 0.8% stamp duty; or mortgages, which trigger a 1% stamp duty.

A significant potential tax burden/risk has been removed from granting loans to Austrian borrowers, because of the abolition of Austrian stamp duty (*Rechtsgeschäftsgebühr*) on loans (*Darlehen*) and credits (*Kredite*), effective for loans and credits granted on or after 1 January 2011.

When creating mortgages, the underlying pledge agreement must be authenticated to obtain registration in the land register. Notarisation fees usually depend on the value of the transaction. In addition, registration of mortgages in the land register triggers a registration fee of 1.2% of the fair value of the mortgage.

3.10 Do the filing, notification or registration requirements in relation to security over different types of assets involve a significant amount of time or expense?

Registers for perfection of security over assets exist in Austria for mortgages and – even though in principle an entry in the books of the owner of IP rights is also considered a permissible method of perfection of, e.g., trademark pledges – the trademark and patent register. Thus, only in respect of mortgages and IP rights will public authorities be involved in the perfection (registration) process of pledges. Registration of pledges in those registers shall usually be completed in a timeframe of up to two weeks. If timing is of the essence, informal pre-notification to the register is a practical means to ensure a swift process.

3.11 Are any regulatory or similar consents required with respect to the creation of security?

No regulatory or similar consents are required with respect to the creation of security. It shall be noted, however, that if, e.g., a mortgage is created or shares are pledged in a corporation owning real estate, the realisation of such collateral might be hampered by the fact that the acquisition of real estate by non-Austrian parties might be subject to restrictions as to real estate transfer in relation to foreign parties. Further, the realisation of pledges in shares or in a business may be subject to merger control.

3.12 If the borrowings to be secured are under a revolving credit facility, are there any special priority or other concerns?

No special priorities or other concerns exist in relation to the securing of revolving borrowings, provided that, if future claims are to be secured, such future claims must be clearly identifiable.

3.13 Are there particular documentary or execution requirements (notarisation, execution under power of attorney, counterparts, deeds)?

With regard to notarisations, see questions 3.3 and 3.6 above. Where a security agreement is executed on the basis of a power of attorney (*Vollmacht*), parties require authorisation pursuant to the power of attorney to be evidenced on the basis of a complete chain of corresponding powers certified by notaries or corresponding entries in commercial registers (*Firmenbuch*). In case a power of attorney is executed by a foreign company, a foreign notary may confirm the identity of the signatories and the content of the respective foreign commercial register. In some cases of foreign certification, an apostille is required.

4 Financial Assistance

4.1 Are there prohibitions or restrictions on the ability of a company to guarantee and/or give security to support borrowings incurred to finance or refinance the direct or indirect acquisition of: (a) shares of the company; (b) shares of any company which directly or indirectly owns shares in the company; or (c) shares in a sister subsidiary?

As set out in more detail in question 2.1 above, Austrian companies are subject to strict capital maintenance rules, which generally (subject to exemptions which are described in questions 2.1 above) do not permit up-stream guarantees or other up-stream securities. Thus, in case of acquisition of shares in a company, such acquisition must not be collateralised by shares of the target company. The same restrictions apply to "sister subsidiaries", if they are directly or indirectly subsidiaries of the target's direct and indirect shareholders.

On the other hand, down-stream collateral, such as shares in a direct or indirect shareholder company (holding company) of the target company, can serve as collateral for the acquisition financing without violating the down-stream collateral capital maintenance rules.

5 Syndicated Lending/Agency/Trustee/ Transfers

5.1 Will your jurisdiction recognise the role of an agent or trustee and allow the agent or trustee (rather than each lender acting separately) to enforce the loan documentation and collateral security and to apply the proceeds from the collateral to the claims of all the lenders?

Accessory collateral, such as sureties or pledges, must not be separate from the underlying secured obligation, otherwise the collateral will cease. Therefore, the concept of "security trustees" or agents, as well as a generic type of "parallel debt", is not recognised under Austrian law to validly establish collateral for one "security agent" which is not at the same time a lender or not a lender in respect of all obligations which shall be secured by the (accessory) collateral. It is, therefore, market practice to include a parallel debt structure for the security trustee concerning security governed by Austrian law. In order to ensure accessory, the Austrian market practice either provides that all secured parties are at the same time pledgees (or direct beneficiaries) under the security agreements or that a "security agent" is appointed, whereby it is agreed among all lenders with the consent of the borrower (or other obligors) that such security agent is the joint and several creditor (*Gesamthandgläubiger*) of all claims, it being further agreed among all creditors that only the security agent shall (following a decision process among all lenders) have the right to enforce the collateral and will then distribute the proceeds from such enforcement among all lenders in proportion to their exposure under the secured obligations.

In respect of non-accessory collateral (e.g. guarantees), it is not required for their validity that they are directly connected with the secured obligation. However, since loan documentation typically includes accessory and non-accessory collateral, it is market practice to provide for joint and several creditorships if the lenders desire to execute their rights arising from the collateral via one security agent.

5.2 If an agent or trustee is not recognised in your jurisdiction, is an alternative mechanism available to achieve the effect referred to above which would allow one party to enforce claims on behalf of all the lenders so that individual lenders do not need to enforce their security separately?

As discussed in question 5.1, the most common lending practice provides that the (Austrian type of) security agent is a joint and several creditor (*Gesamthandgläubiger*) of all claims of any of the lenders.

5.3 Assume a loan is made to a company organised under the laws of your jurisdiction and guaranteed by a guarantor organised under the laws of your jurisdiction. If such loan is transferred by Lender A to Lender B, are there any special requirements necessary to make the loan and guarantee enforceable by Lender B?

In this context, it is necessary to observe that Austrian law differentiates between fully abstract guarantees (*Garantien*) and sureties (*Bürgschaften*).

Guarantees are considered to be separate non-accessory claims against the guarantor according to Austrian law. Therefore, generally, a guarantee would need to be assigned to Lender B, provided, however, that the guarantor retains all objections *vis-à-vis* Lender B that result from the guarantee agreement with Lender A upon a transfer of the loan and assignment of the guarantee.

In contrast, sureties are considered to be accessory claims according to Austrian law, which are consequently automatically transferred upon assignment of the secured loan. Another difference to guarantees is that the grantor of a surety is not only entitled to raise objections resulting from the surety upon transfer of the loan, but also to raise objections which stem from the relationship between the obligor and creditor under the loan agreement.

6 Withholding, Stamp and Other Taxes; Notarial and Other Costs

6.1 Are there any requirements to deduct or withhold tax from (a) interest payable on loans made to domestic or foreign lenders, or (b) the proceeds of a claim under a guarantee or the proceeds of enforcing security?

Generally, repayments of principal under loan transactions are not subject to withholding tax. In addition, interest payments are not subject to withholding tax as a general rule. Rather, such payments will have to be taken into account for purposes of the (corporate) income tax of the lender. If payment of interest is effected, however, to a non-Austrian lender then withholding tax in the amount of 35% may apply.

There are numerous double taxation treaties concluded between Austria and other jurisdictions, which typically provide for such withholding tax to be considered as deductible and/or refundable. Even though there is a new OECD model convention in force as from 2017 and such model convention is also applicable to existing tax treaties due to acceptance through the MLI (Multilateral Instrument), there are no changes in this respect.

Due to the introduction of comprehensive cross-border information undertakings among authorities, the withholding tax legislation is not applicable from the end of 2016 onwards.

As regards proceeds of a claim under a guarantee or the proceeds of enforcing security, there is generally also no requirement imposed by Austrian law to deduct or withhold tax.

6.2 What tax incentives or other incentives are provided preferentially to foreign lenders? What taxes apply to foreign lenders with respect to their loans, mortgages or other security documents, either for the purposes of effectiveness or registration?

No Austrian taxes of any kind, e.g., stamp duty, issue, registration or similar taxes apply with regard to loans, mortgages or other security document for their effectiveness or registration and, similarly, no incentives whatsoever are provided in a preferential way to foreign lenders.

In case the foreign lender acts as an investor, the Austrian government in general would welcome such foreign direct investment. This is especially the case if those investments have the prospect to create new jobs in high-tech fields or promote capital-intense industries (cash grants may possibly be awarded). A particular focus is also given to investments that enhance research and development where specific tax incentives are available. A similar priority for the government is the environment; thus investments should not have any negative impact in this regard. Financial incentives may also be provided according to EU guidelines to promote investment in Austria, which are equally available to domestic and foreign investors, and range from tax incentives to preferential loans, guarantees and grants. Most of these incentives are available only if the planned investment meets specified criteria (e.g. implementation of new technology or reduction of unemployment).

6.3 Will any income of a foreign lender become taxable in your jurisdiction solely because of a loan to, or guarantee and/or grant of, security from a company in your jurisdiction?

Generally, no income of a foreign lender will become taxable in Austria, solely because of a loan, a guarantee or generally the grant of a company in Austria.

6.4 Will there be any other significant costs which would be incurred by foreign lenders in the grant of such loan/guarantee/security, such as notarial fees, etc.?

In Austria, no taxes or stamp duty will apply for the granting of loans (such loan fees were abolished in Austria in 2011) or (abstract) guarantees.

With regard to surety agreements and mortgages, stamp duty at the rate of 1% of the secured interest will apply. Similarly, for assignments, stamp duty at the rate of 0.8% of the secured interest will apply. In connection with bill transactions, stamp duty at the rate of 0.125% of the secured interest will apply.

Also, notary fees may be payable; e.g. with respect to the creation of mortgages, which must be notarised for registration and will depend on the transaction value. In addition, the registration of a mortgage in the land register will incur a registration fee of 1.2% of the mortgage.

6.5 Are there any adverse consequences for a company that is a borrower (such as under thin capitalisation principles) if some or all of the lenders are organised under the laws of a jurisdiction other than your own? Please disregard withholding tax concerns for purposes of this question.

In general, Austrian law does not provide for any such consequences.

7 Judicial Enforcement

7.1 Will the courts in your jurisdiction recognise a governing law in a contract that is the law of another jurisdiction (a "foreign governing law")? Will courts in your jurisdiction enforce a contract that has a foreign governing law?

Austrian law and conflicts of law rules generally permit the choice of foreign law as the governing law of a contract, which is also the case if the respective contract is to be enforced in Austria. Regulation (EC) 593/2008 of 17 June 2008 on the Law applicable to Contractual Obligations (*Rom I Verordnung*) is applicable in Austria and must be observed in this context. Following such Regulation, Austrian courts will principally recognise the contractual choice of foreign law, subject to certain requirements (e.g. actual conflict of laws, or the contract relates to a civil and/or commercial matter), and to this extent, Austrian courts have jurisdiction for claims under such a contract. However, some restrictions apply regarding the granting and perfection of security rights, which, depending on the type of security, is in many cases governed by local Austrian law (e.g. for pledges over shares in Austrian companies, pledges over security assignments of Austrian law-governed receivables or for the creation of mortgages over real estate properties located in Austria). Hence it is common market practice that security rights over assets that are located in Austria, including those which are provided by Austrian domiciled transferors or pledgors, have Austrian law-governed security documentation.

Also, in cases where there is no actual conflict of law or where the contract is solely connected to EU Member States, the parties are not allowed to choose the law of a non-Member State. Additionally, no choice of law will be recognised by Austrian courts which would violate Austrian *ordre public*.

7.2 Will the courts in your jurisdiction recognise and enforce a judgment given against a company in New York courts or English courts (a "foreign judgment") without re-examination of the merits of the case?

As regards the enforcement of judgments or awards that were not rendered in Austria, there are generally the following options:

- Court judgments of EU Member States: The enforcement of judgments rendered in another EU Member State is governed by Regulation (EC) No 1215/2012 on the Jurisdiction and Recognition and Enforcement of Judgments in Civil and Commercial Matters (Brussels Ia Regulation). As in Austria the Brussels Ia Regulation is applicable, judgments from other EU Member States are recognised without any special procedure being required or any re-examination of the merits of the case (exceptions may apply, mainly with respect to Austrian *ordre public*).
- Court judgments of non-EU Member States: Beyond the applicability of the Brussels Ia Regulation, enforceability of foreign judgments is conditional and depends on whether there is a bilateral treaty between Austria and the domicile of the other party. According to Austrian law, reciprocity is ensured under bilateral treaties/regulations and is assumed as a fundamental criterion for the enforcement of court judgments. Additionally, it is required that Austrian law would not have denied the foreign court, having rendered the relevant decision, if the defendant in the enforcement proceedings has been duly convoked in the original proceedings before the foreign court and if the relevant judgment is final in the sense that it may no longer be challenged before the courts and authorities of the foreign state. In case the counterparty had not had the opportunity to participate in the foreign court proceedings, the enforcement of such court judgment may be denied. The same applies in case the enforcement is aimed at an action which may not be enforced or that is not allowed under Austrian law, or if the Austrian *ordre public* would be violated.
- Arbitral awards: Austria is a contracting state of the New York Convention on the Recognition and Enforcement of Foreign Arbitral Awards. Arbitral proceedings and the enforcement of arbitral awards are common in Austria (see in this respect question 7.7 below).

7.3 Assuming a company is in payment default under a loan agreement or a guarantee agreement and has no legal defence to payment, approximately how long would it take for a foreign lender to (a) assuming the answer to question 7.1 is yes, file a suit against the company in a court in your jurisdiction, obtain a judgment, and enforce the judgment against the assets of the company, and (b) assuming the answer to question 7.2 is yes, enforce a foreign judgment in a court in your jurisdiction against the assets of the company?

As a general rule, the duration of court proceedings depends on several factors such as the complexity of the case and the overall workload of the specific court. Usually (considering the above-mentioned factors) a judgment might be expected within one year with regard to (a). With regard to question (b), the best case scenario for an enforcement of a judgment from an EU Member State may be expected within a few days and a couple of months in case of judgments from a non-EU Member State. Although those estimations are generally applicable, they vary from case to case and proceedings could require significantly more time. The timeframe may be stretched by remedies especially, and in particular by appeal against first instance judgments, as is the case most of the time.

7.4 With respect to enforcing collateral security, are there any significant restrictions which may impact the timing and value of enforcement, such as (a) a requirement for a public auction, or (b) regulatory consents?

For the different types of securities and any other contractual arrangements, the enforcement of contractual security rights varies significantly. Security rights are usually enforced through statutory law applied by courts as a general principle, but deviations are possible in case of contractual arrangements between parties, which are permissible. Regarding the most relevant types of security, the following statutory rules and market practices apply:

Share pledges: Common market practice for shares in Limited Liability Companies and shares in Stock Corporations is to agree on out-of-court enforcements. This requires notification of the pledgor as well as a valuation of the shares and subsequent disposal to the best bidder (usually the pledgor is also granted the right to participate in the bidding process).

Mortgages: A public auction is required for mortgages; the involvement of the court could lead to delays in the enforcement procedure.

Receivables: There is no specific enforcement procedure in place for receivables. The assignee (or the pledgee if granted a power to collect) is entitled to directly claim the payment from the debtor in case of default.

Guarantees/suretyships: There is no specific type of enforcement procedure for personal security such as guarantees or surety. Following the terms and conditions agreed in the security arrangement (e.g. priorities), the payment can be requested directly from the obligor (and enforced in court proceedings).

Movable property: The standard practice for movable property is to modify the enforcement procedure under statutory law to permit out-of-court enforcements. Adhering to a cooling-off period of one month and following public auctions, movable goods may be sold after notification of the pledgor.

7.5 Do restrictions apply to foreign lenders in the event of (a) filing suit against a company in your jurisdiction, or (b) foreclosure on collateral security?

Foreign lenders may be required to deposit court fees before proceedings commence. Lenders seated in EU Member States or states that are party to the Hague Convention on Civil Procedure of 1 March 1954 are usually not required to post collaterals for court costs.

7.6 Do the bankruptcy, reorganisation or similar laws in your jurisdiction provide for any kind of moratorium on enforcement of lender claims? If so, does the moratorium apply to the enforcement of collateral security?

As of the opening of the insolvency proceedings, the litigation and execution of claims by individual creditors is no longer permitted. As of such date, the enforcement of a claim requires its filing as an insolvency claim (*Insolvenzforderung*) with the insolvency court. The application period (*Anmeldungsfrist*) is published in the decree; however, the claim can also be filed after expiration of such period, although additional court fees may apply. Afterwards, the insolvency administrator collects all claims in the claim table (*Anmeldeverzeichnis*), which is presented to the court. During the examination hearing (*Prüfungstagsatzung*), all duly filed claims are examined. At such hearing, the insolvency administrator must declare which of the individual claims shall be acknowledged or declined. For a claim to be considered acknowledged, however, it is also required that no other creditor contests such claim. When acknowledged, the creditor will be take part *pro rata* in the distribution of the applicable insolvency quota. With regard to the enforcement of collateral security, please see questions 8.1 and 8.2 below.

7.7 Will the courts in your jurisdiction recognise and enforce an arbitral award given against the company without re-examination of the merits?

An arbitral award rendered by an arbitral tribunal having its seat in Austria generally constitutes an executory title under the Austrian Enforcement Act (*Exekutionsordnung*) and does not require a declaration of enforceability by a domestic court. Under these circumstances, it is considered sufficient to attach to the enforcement request a copy of such arbitral award with a confirmation of its final and binding nature and enforceability issued primarily by the chairman of the arbitral tribunal.

In respect of foreign arbitral awards, the New York Convention of 1958 is the prime basis for the recognition and enforcement. Sec. 611 Austrian Code on Civil Procedure (*Zivilprozessordnung*) provides possible legal grounds for re-examining/setting aside an arbitral award. However, in general, an Austrian Court will not re-examine the merits of an arbitral case, but review the award with regard to procedural errors (e.g. if the decided dispute is not covered by the arbitral agreement or if an arbitral agreement does not exist at all or if the matter in dispute must not be arbitrated). Certain exceptions apply; especially where an arbitral award conflicts with the fundamental values of the Austrian legal system (*ordre public*).

8 Bankruptcy Proceedings

8.1 How does a bankruptcy proceeding in respect of a company affect the ability of a lender to enforce its rights as a secured party over the collateral security?

A secured creditor is barred from exercising enforcement rights regarding its security for a maximum period of six months after the opening of insolvency proceedings, if the exercise of such enforcement rights would endanger the operation of the debtor's business. However, this does not apply where the performance of such enforcement rights is necessary to prevent the secured creditor from being exposed to severe personal or economic danger, provided that it is not possible (and will not be possible) to provide full satisfaction to the creditor by execution into other assets of the debtor.

In insolvency proceedings, secured creditors are divided into categories. The claims of secured creditors are settled in a determined order. First, rights to separation of property (*Aussonderungsrechte*) are handled. Property of third parties caught in the insolvency proceedings must be returned to such third parties. After that, rights to separate satisfaction (*Absonderungsrechte*) are handled. Separate satisfaction is granted to creditors, whose claims are secured by a pledge or otherwise either by law or by agreement. The insolvency administrator may initiate auctions or forced administration of the insolvency estate's immovable assets, even if the asset is subject to a right of separate satisfaction.

8.2 Are there any preference periods, clawback rights or other preferential creditors' rights (e.g., tax debts, employees' claims) with respect to the security?

The Austrian Insolvency Act provides rules which enable creditors to contest certain transactions which possibly decrease the assets of the debtor prior to the opening of insolvency proceedings. In this respect, transactions that were entered into by the debtor and a third party, which discriminate other creditors, might be contested. The respective transaction must be contested by the appointed insolvency administrator.

Generally, for the contestation of transactions, the following is required: (i) an existing transaction; (ii) such transaction is entered into prior to the opening of the insolvency proceedings; (iii) the transaction somehow decreases the assets of the debtor; (iv) the transaction discriminates other creditors; and (v) the claim fulfils one of the specific contesting provisions of the Austrian Insolvency Act.

The Austrian Insolvency Act provides basically for the following specific contesting provisions:

1. Discriminatory intent (*Benachteiligungsabsicht*):

   This provision applies if the debtor acted with the intent to discriminate creditors and the other party either knew of this intent (in this case all transactions within the last 10 years prior to the initiation of insolvency proceedings are impeachable) or should have been aware of it (then all transactions up to two years preceding the initiation of insolvency proceedings are covered).
2. Squandering of assets (*Vermögensverschleuderung*):

   A transaction is contestable if it is seen as squandering the company's assets. The other party must have known or should have been aware of this (transactions up to one year preceding the initiation of insolvency proceedings).
3. Dispositions free of charge (*Unentgeltliche Verfügungen*):

   Transactions that were made free of charge and which were entered into within the two years prior to the opening of the insolvency proceedings are contestable.
4. Preferential treatment of creditors (*Begünstigung*):

   This provision applies where a transaction discriminates one creditor *vis-à-vis* the others or is intended to prefer one creditor *vis-à-vis* the others after the debtor is materially insolvent or after the application for the opening of insolvency proceedings has been submitted or 60 days prior to either such event.
5. Knowledge of illiquidity (*Kenntnis der Zahlungsunfähigkeit*):

   A legal act based on the knowledge of illiquidity of the debtor might be contested after illiquidity has occurred, where the contracting third party knew or negligently was not aware of the debtor's illiquidity.

All the provisions outlined above secure the debtor's assets prior to the opening of the proceedings. After opening of the insolvency proceedings and appointment of an insolvency administrator, the debtor is solely represented by the insolvency administrator. This does not apply where insolvency proceedings were opened as restructuring proceedings by self-administration of the debtor (*Sanierungsverfahren mit Eigenverwaltung*), which, under certain circumstances is subject to the consent of the insolvency administrator, the court or the creditor's committee. Otherwise, any transaction or disposition of a debtor's property can only be undertaken by the insolvency administrator (and under certain circumstances requires the consent of the court or the creditor's committee) after the opening of insolvency proceedings.

Estate claims (*Masseforderungen*) are generally preferred claims when the general estate (not the preferred estate) is distributed. Such estate claims comprise, e.g., claims for the general continuing of the business, including claims of employees, after opening of the insolvency proceedings.

8.3 Are there any entities that are excluded from bankruptcy proceedings and, if so, what is the applicable legislation?

Austrian insolvency law is generally not limited to any type of entity. The insolvency ability is rather defined as part of the private law legal capacity. Therefore, generally, any natural person, as well as legal entities (private or public) and inheritances can be a debtor and can become insolvent.

With regard to banks, investment firms, investment services companies and insurance companies, it should be noted that such entities may be subject to winding-up but not to bankruptcy procedures.

8.4 Are there any processes other than court proceedings that are available to a creditor to seize the assets of a company in an enforcement?

If no out-of-court seizure of assets is agreed upon (or even in case such agreement is made but not observed by the debtor), the process for seizure of assets of companies has to be made via court enforcement.

9 Jurisdiction and Waiver of Immunity

9.1 Is a party's submission to a foreign jurisdiction legally binding and enforceable under the laws of your jurisdiction?

The contractual choice of forum is generally permissible and legally binding as defined per Art. 25 of the Brussels Ia Regulation, which is applicable for cross-border scenarios in case a party submits to a foreign jurisdiction, although specific form requirements may apply. It is also permissible if expressed and agreed that the forum shall be chosen by one party. It needs to be considered that, for instances where the courts have exclusive jurisdiction pursuant to Art. 24 Brussels Ia Regulation, no choice of forum is permissible. This applies especially to proceedings in respect to rights *in rem*.

The Brussel Ia Regulation may not be applicable in case only one party has its domicile in an EU Member State and the other party also has its domicile in the same country or in a non-EU Member State. The choice of jurisdiction clause would then be governed by domestic law. In any case, domestic rules also correspond to the Brussel I Regulation to a large extent.

9.2 Is a party's waiver of sovereign immunity legally binding and enforceable under the laws of your jurisdiction?

Provided it does not conflict with public international law or special immunities, such as diplomatic immunity, a waiver of sovereign immunity is usually legally binding.

10 Licensing

10.1 What are the licensing and other eligibility requirements in your jurisdiction for lenders to a company in your jurisdiction, if any? Are these licensing and eligibility requirements different for a "foreign" lender (i.e. a lender that is not located in your jurisdiction)? In connection with any such requirements, is a distinction made under the laws of your jurisdiction between a lender that is a bank *versus* a lender that is a non-bank? If there are such requirements in your jurisdiction, what are the consequences for a lender that has not satisfied such requirements but has nonetheless made a loan to a company in your jurisdiction? What are the licensing and other eligibility requirements in your jurisdiction for an agent under a syndicated facility for lenders to a company in your jurisdiction?

In order to provide loan financing on a commercial level to companies in Austria, there are three possible options:

- Application for a banking licence. Obtaining a banking licence is a rather complicated procedure and requires in-depth preparation over a longer period of time. The legal requirements that have to be fulfilled are especially extensive, as is the creation of an appropriate business plan that has to be reviewed by the regulator.
- A credit institute of another EU Member State may establish a branch (requires an existing banking licence, which would need to be notified to the Austrian regulator).
- Utilising the EU freedom of service to render services in Austria, which is the most common approach for non-Austrian banks that want to become active in the lending business and wish to avoid establishing a permanent presence.

Non-banks may only engage in the lending business to the extent that such activity is exempted from the requirement to hold a banking licence (e.g. acquisition of loan portfolios by special securitisation purpose entities).

11 Other Matters

11.1 Are there any other material considerations which should be taken into account by lenders when participating in financings in your jurisdiction?

Directive (EU) 2018/843 of the European Parliament and of the Council of 30 May 2018 amending Directive (EU) 2015/849 on the prevention of the use of the financial system for the purposes of money laundering or terrorist financing became effective on 9 July 2018. This Directive must be implemented by the EU Member States by 10 January 2020. The main changes are: (i) the reduction of thresholds below which no proof of identity is required; (ii) the inclusion of cryptocurrencies and other related electronic cash systems; (iii) a higher duty of care regarding high-risk countries; (iv) the expansion of Financial Intelligence Units; and (v) higher transparency regarding beneficial owners. Among others, the Financial Market Anti-Money Laundering Act applies to credit and financial institutions under the Austrian Banking Act, including CRR institutions pursuant to Sec. 9 of the Austrian Banking Act, which has a significant impact on know your customer checks. Those checks have to be conducted by the respective institutions in relation to their customers. Appropriate steps have to be taken by each institution to identify, access and mitigate risks of money laundering and terrorist financing. Also, risk factors that relate to their customers, geographic areas, products, services, transactions or any delivery channels have to be taken into account. This should prevent the use of the EU financial system for money laundering and terrorist financing.

Another aspect that may need to be observed is the Act on Equity Replacement (*Eigenkapitalersatz-Gesetz*), according to which shareholders with a controlling interest of more than 25%, who make payments to a company or provide security for third-party loans to the benefit of a company during a crisis of such company, are treated subordinately compared to other lenders, if such company becomes insolvent.

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Belgium

Astrea

Dieter Veestraeten

1 Overview

1.1 What are the main trends/significant developments in the lending markets in your jurisdiction?

On 1 January 2018, the new Belgian act on security interests on movable assets entered into force. This new act modernised and simplified, and significantly modified the previous rules for the creation, perfection and enforcement of security interests on movable assets under Belgian law. One of the most remarkable innovations is the introduction of a new non-possessory pledge which is subject to registration in a new public register, the national pledge register. The new collateral act is expected to enhance the granting of credit to companies, in particular in the fields of trade finance and asset-based lending. The collateral act has also introduced the concept of a security agent, which can enter into a pledge agreement with respect to movable assets as a representative of one or more beneficiaries.

Moreover, on 1 May 2018, the reformed insolvency law entered into force, which was integrated in Book XX of the Code of Economic Law.

Another relevant development is the fundamental reform of Belgian company law. On 28 February 2019, the Belgian parliament approved the new Code of Companies and Associations. The new Companies Code is a real 'game changer', focusing on modernisation and improving the flexibility of the Belgian rules governing both companies and associations. The new Companies Code enters into force on 1 May 2019.

1.2 What are some significant lending transactions that have taken place in your jurisdiction in recent years?

There are no official reports on lending transactions, so we cannot comment on specific lending transactions of the past years. In general, it can be said that the lending climate remains borrower friendly, as lending conditions are favourable and interest rates remain relatively low. This is not only a trend in Belgium, but also in the entire euro zone. According to the October 2018 bank lending survey of the ECB, credit standards eased further for loans to enterprises in the third quarter of 2018 and demand increased across all loan categories.

2 Guarantees

2.1 Can a company guarantee borrowings of one or more other members of its corporate group (see below for questions relating to fraudulent transfer/financial assistance)?

Yes, provided that the guarantee falls within the guarantor's corporate purpose (see below) and corporate benefit.

The corporate benefit requirement should be assessed by the guarantor's board of directors, taking into account: (1) any direct and/or indirect benefits the guarantor derives from the loan; (2) the balance between the risk relating to the guarantee and the benefit for the guarantor; and (3) the guarantor's financial capacity.

It is market practice for Belgian subsidiaries granting a cross-stream or up-stream guarantee to include so-called "limitation language" in credit agreements, guarantees and security documents. Although not required by law, this reduces (but not excludes) the risk of violating Belgian corporate benefit rules.

2.2 Are there enforceability or other concerns (such as director liability) if only a disproportionately small (or no) benefit to the guaranteeing/securing company can be shown?

If the corporate benefit requirement is not met, the guarantee can be held null and void and the directors of the company may be held liable (i) by the company for negligence in the management of the company, and (ii) by third parties in tort. However, these rules have been seldom tested under Belgian law, and there is only limited case law on this issue.

2.3 Is lack of corporate power an issue?

Yes, a guarantee must always serve the guarantor's corporate purpose, as mentioned in its articles of association. However, if the corporate purpose test is not met, the guarantee can only be held void towards a third party, if that party knew or should have known that the transaction was *ultra vires*. Lenders are reasonably expected to verify a borrower's or guarantor's articles of association prior to granting a loan.

2.4 Are any governmental or other consents or filings, or other formalities (such as shareholder approval), required?

In general, no. However, in case of a public limited liability company (*naamloze vennootschap/société anonyme*), the guarantor's general shareholders' meeting must approve any change of control clauses in the finance documents which may result in an early repayment of the guaranteed liabilities and the shareholders' resolutions must be filed with the commercial court. If not, such change of control clauses are null and void.

2.5 Are net worth, solvency or similar limitations imposed on the amount of a guarantee?

Belgian law does not impose any specific solvency limitations; the general test for assessing the amount of the guarantee is the corporate benefit test (see above). In view hereof, guarantee limitation wording based on the net asset value of the guarantor are usual in Belgium.

2.6 Are there any exchange control or similar obstacles to enforcement of a guarantee?

There are no such exchange controls or other obstacles in Belgium.

3 Collateral Security

3.1 What types of collateral are available to secure lending obligations?

The following types of collateral are usual in Belgium: mortgage on real estate; mortgage mandates; and pledge on (i) movable assets, (ii) the entire business, (iii) financial instruments (including shares and bank accounts), (iv) receivables, or (v) IP rights.

3.2 Is it possible to give asset security by means of a general security agreement or is an agreement required in relation to each type of asset? Briefly, what is the procedure?

In principle, a separate pledge agreement will be required for each asset type. Another possibility is a non-possessory pledge on the pledgor's entire business, which must be registered in the national pledge register in order to be enforceable.

3.3 Can collateral security be taken over real property (land), plant, machinery and equipment? Briefly, what is the procedure?

Security over real property is created by a mortgage. It is created by a public deed before a notary and must be registered with the mortgage register. It can, under certain conditions, either include plant, machinery and equipment, or these can be pledged by means of a pledge that must be registered in the national pledge register to be effective against third parties.

A mortgage mandate (i.e., an irrevocable proxy to vest a mortgage) does not create any security right *in rem* and will only become perfected and take rank as of the moment of its conversion.

3.4 Can collateral security be taken over receivables? Briefly, what is the procedure? Are debtors required to be notified of the security?

Yes, a pledge over receivables can be created by a pledge agreement, which is perfected and enforceable against third parties upon its execution. However, the pledge only becomes enforceable against the debtor of the pledged receivable as of the date of notification of the pledge to, or the acknowledgment of the pledge by, this debtor.

3.5 Can collateral security be taken over cash deposited in bank accounts? Briefly, what is the procedure?

Bank deposits qualify as receivables held against the account bank and can be pledged by way of a pledge agreement. The pledge only becomes enforceable against the account bank as of the date of notification of the pledge to, or the acknowledgment of the pledge by, the account bank. The same procedure as set out in question 3.4 applies.

3.6 Can collateral security be taken over shares in companies incorporated in your jurisdiction? Are the shares in certificated form? Can such security validly be granted under a New York or English law-governed document? Briefly, what is the procedure?

Yes, unless restricted in the articles of association. Foreign law chosen by the parties may govern the contractual aspects of the pledge, except for the proprietary aspects of the security which will be governed by Belgian law if the company is located in Belgium, or if the dematerialised shares are registered in a special account in Belgium. To become effective: (1) a pledge on registered shares must be recorded in the company's share register; and (2) a pledge on dematerialised assets must be registered in a special financial account.

3.7 Can security be taken over inventory? Briefly, what is the procedure?

Yes, as a non-possessory pledge on inventory, which must be registered in the national pledge register to be effective against third parties.

3.8 Can a company grant a security interest in order to secure its obligations (i) as a borrower under a credit facility, and (ii) as a guarantor of the obligations of other borrowers and/or guarantors of obligations under a credit facility (see below for questions relating to the giving of guarantees and financial assistance)?

A Belgian company can grant a security interest in both situations, save for the limitations of the corporate purpose and benefit (see questions 2.2 and 2.3) and financial assistance (question 4.1).

3.9 What are the notarisation, registration, stamp duty and other fees (whether related to property value or otherwise) in relation to security over different types of assets?

A mortgage must be vested by notarial deed and registered with the mortgage register; this entails the payment of registration duties (1.30% of the secured amount), notary fees and possible additional costs.

The registration of a pledge on movable assets in the national pledge register costs up to €500 per registration.

3.10 Do the filing, notification or registration requirements in relation to security over different types of assets involve a significant amount of time or expense?

Registration of a pledge in the national pledge register can be done online. The pledge is effective immediately after payment of the registration fee. Mortgages take longer, as they require notary involvement (at least three to four weeks).

3.11 Are any regulatory or similar consents required with respect to the creation of security?

In general, no.

3.12 If the borrowings to be secured are under a revolving credit facility, are there any special priority or other concerns?

In principle, no. Security can also be vested for future debts.

3.13 Are there particular documentary or execution requirements (notarisation, execution under power of attorney, counterparts, deeds)?

In general, no. However, a notarial deed is required to document a mortgage.

4 Financial Assistance

4.1 Are there prohibitions or restrictions on the ability of a company to guarantee and/or give security to support borrowings incurred to finance or refinance the direct or indirect acquisition of: (a) shares of the company; (b) shares of any company which directly or indirectly owns shares in the company; or (c) shares in a sister subsidiary?

(a) Shares of the company

Belgian law prohibits a Belgian company from granting a guarantee or security to secure a loan which shall or has been used to fund directly or indirectly the acquisition of shares of such a company. Although these provisions on financial assistance were relaxed from the start of 2009, they still substantially hamper the structuring of acquisition financing.

The new Companies Code will introduce the principle that a company is allowed to grant financial assistance, but this may not be done with disregard to the rights of minority shareholders, nor may it jeopardise the continuity of the company. Only funds that are eligible for distribution can be used to provide financial assistance. In order that available funds are not used several times, the creation of an unavailable reserve for the value of the financial assistance will be required. Finally, the shareholders meeting has to authorise the transaction, which will then be carried out under the responsibility of the management body that draws up a special report for this purpose.

(b) Shares of any company which directly or indirectly owns shares in the company or shares in a sister company

The financial assistance rules do not apply when a Belgian company guarantees or secures borrowings used to acquire shares in a parent or sister company. However, it should be verified if the corporate interest test for such transaction is met.

5 Syndicated Lending/Agency/Trustee/Transfers

5.1 Will your jurisdiction recognise the role of an agent or trustee and allow the agent or trustee (rather than each lender acting separately) to enforce the loan documentation and collateral security and to apply the proceeds from the collateral to the claims of all the lenders?

Yes, the financial collateral act (which applies to financial collateral such as shares and bank accounts) and the new rules in the Civil Code with respect to pledges on movable assets explicitly recognise the concept of a security agent. For mortgages, the concept of a security agent does not exist yet and a parallel debt structure might be required. The concept of trust does currently not exist in Belgian law.

5.2 If an agent or trustee is not recognised in your jurisdiction, is an alternative mechanism available to achieve the effect referred to above which would allow one party to enforce claims on behalf of all the lenders so that individual lenders do not need to enforce their security separately?

Alternative mechanisms to allow one party to enforce the loan documentation and collateral security include parallel debt structures or joint creditorship.

5.3 Assume a loan is made to a company organised under the laws of your jurisdiction and guaranteed by a guarantor organised under the laws of your jurisdiction. If such loan is transferred by Lender A to Lender B, are there any special requirements necessary to make the loan and guarantee enforceable by Lender B?

The loan can be transferred by (a) assignment, or (b) novation.

(a) Upon an assignment, all accessory rights and security will follow the principal debt (i.e. the loans). All underlying debtors must be notified for the transfer to be effective. An unnotified debtor in good faith remains entitled to act (e.g. by paying or applying set-off to the original lender).

(b) Upon novation, new debt is created. Therefore, all accessory rights and security attached to the original debt will cease to exist, unless expressively stated otherwise.

A transfer of a mortgage backed claim must be registered in the mortgage register. This requires a notarial deed.

A transfer of a registered pledge on movable assets must be registered in the national pledge register. This can be done online.

6 Withholding, Stamp and Other Taxes; Notarial and Other Costs

6.1 Are there any requirements to deduct or withhold tax from (a) interest payable on loans made to domestic or foreign lenders, or (b) the proceeds of a claim under a guarantee or the proceeds of enforcing security?

(a) A 30% withholding tax rate applies to interest payments to domestic and foreign lenders, unless exceptions or reductions from withholding taxes apply deriving from Belgian law provisions or double-tax treaties. US and EEA credit institutions are, in principle, exempt.

(b) In principle, none.

6.2 What tax incentives or other incentives are provided preferentially to foreign lenders? What taxes apply to foreign lenders with respect to their loans, mortgages or other security documents, either for the purposes of effectiveness or registration?

None (save for the exceptions mentioned in question 6.1). The same taxes apply to Belgian and foreign lenders.

6.3 Will any income of a foreign lender become taxable in your jurisdiction solely because of a loan to, or guarantee and/or grant of, security from a company in your jurisdiction?

In principle, no.

6.4 Will there be any other significant costs which would be incurred by foreign lenders in the grant of such loan/guarantee/security, such as notarial fees, etc.?

In principle, no, since typically all costs (e.g. notary fees and registration duties for vesting a mortgage) are borne by the borrower.

6.5 Are there any adverse consequences for a company that is a borrower (such as under thin capitalisation principles) if some or all of the lenders are organised under the laws of a jurisdiction other than your own? Please disregard withholding tax concerns for purposes of this question.

The rules of the EU's Anti-Tax Avoidance Directive on interest limitation will enter into force on 1 January 2020 in Belgium and replace Belgian thin capitalisation rules applicable to interest payments if a related party grants a loan or if this lender is located in a low-tax jurisdiction.

Certain reporting duties and/or proof that the payments were made in the framework of the actual and real activities may be required in order for the interest payments to be deductible, if the borrower's lender is located in a "blacklisted" or low-tax jurisdiction.

Transfer pricing rules require the "at arm's length principle" for borrowings from foreign affiliated lenders.

7 Judicial Enforcement

7.1 Will the courts in your jurisdiction recognise a governing law in a contract that is the law of another jurisdiction (a "foreign governing law")? Will courts in your jurisdiction enforce a contract that has a foreign governing law?

A Belgian court will recognise the parties' contractual choice of foreign law, save for any mandatory provisions of other jurisdictions, applicable EU law, overriding mandatory provisions of the jurisdiction in which the obligations arising out of the contract are performed, Belgian overriding mandatory provisions or Belgian public policy provisions that might override the foreign governing law and apply directly to the contract.

7.2 Will the courts in your jurisdiction recognise and enforce a judgment given against a company in New York courts or English courts (a "foreign judgment") without re-examination of the merits of the case?

In principle, a Belgian court will recognise and enforce such judgment without re-examining the merits of the case, save for some exceptions (e.g. a judgment that is manifestly contrary to Belgian public policy or that violated the rights of defence).

7.3 Assuming a company is in payment default under a loan agreement or a guarantee agreement and has no legal defence to payment, approximately how long would it take for a foreign lender to (a) assuming the answer to question 7.1 is yes, file a suit against the company in a court in your jurisdiction, obtain a judgment, and enforce the judgment against the assets of the company, and (b) assuming the answer to question 7.2 is yes, enforce a foreign judgment in a court in your jurisdiction against the assets of the company?

(a) The regular judicial procedures apply if one or both of the parties is not registered in a European database of enterprises. It will take at least one year to obtain an enforceable judgment, which is, in principle, executable with immediate effect, regardless of any appeal.

Summary proceedings are possible for undisputed debts and usually provide an enforceable judgment within three months, unless the defendant disputes the claim and ordinary proceedings therefore must be held.

(b) In principle, an exequatur is required to enforce a foreign judgment in Belgium and could be obtained within 15–30 days, unless a party files an opposition.

The period for the lender to attach the borrower's assets will depend on the attachable goods (e.g. real estate can take between one and six months due to certain formalities).

A conservatory attachment of assets is possible before a final judgment or exequatur is rendered in certain situations (e.g. pending insolvency) and, generally, takes between five days and three months, depending on the assets and formalities to be fulfilled.

7.4 With respect to enforcing collateral security, are there any significant restrictions which may impact the timing and value of enforcement, such as (a) a requirement for a public auction, or (b) regulatory consents?

(a) Following the competent attachment judge's required permission to enforce a collateral security, a bailiff or public notary will be appointed to sell the assets that the collateral security covers during a public auction. Under certain conditions, a private sale is possible.

Financial collateral or a pledge on movable assets can be enforced in a flexible manner without the prior authorisation of a court.

(b) In principle, no.

7.5 Do restrictions apply to foreign lenders in the event of (a) filing suit against a company in your jurisdiction, or (b) foreclosure on collateral security?

Belgian courts may require a sworn translation of any documents used as evidence and filed in a language other than the language of the court.

At the request of a Belgian defendant, a foreign plaintiff may be required to post a bond to secure payment of any expenses or damages for which the plaintiff might be liable, unless waived in an applicable treaty.

7.6 Do the bankruptcy, reorganisation or similar laws in your jurisdiction provide for any kind of moratorium on enforcement of lender claims? If so, does the moratorium apply to the enforcement of collateral security?

Upon the initiation of reorganisation or bankruptcy proceedings, an automatic stay of enforcement applies. However:

(a) In reorganisation proceedings it still remains possible to create new security and prior conservatory attachments can be enforced under certain conditions. Pledges on specifically pledged receivables, pledges or security assignments on certain financial instruments and netting agreements other than close-out netting agreements remain enforceable too. However, pledges or security assignments of bank accounts cannot be enforced, unless a payment default occurred.

(b) In bankruptcy proceedings there is an automatic annulment of all attachments. However, advanced attachment proceedings can continue under certain conditions. Financial collateral can also be enforced, even after bankruptcy of the pledgor.

7.7 Will the courts in your jurisdiction recognise and enforce an arbitral award given against the company without re-examination of the merits?

An arbitral award will be recognised and enforced without re-examination of the merits subject to the provisions of the New York Arbitration Convention and the provisions of the Belgian Judicial Code, which, however, includes a number of reasons for which an arbitral award cannot be recognised, e.g. if it infringes Belgian public policy or if it has been insufficiently motivated.

8 Bankruptcy Proceedings

8.1 How does a bankruptcy proceeding in respect of a company affect the ability of a lender to enforce its rights as a secured party over the collateral security?

A bankruptcy judgment suspends the enforcement rights of individual creditors. However, the suspension for creditors holding a security interest on specific movable assets and mortgagees will usually be limited up to the closing of the first minutes of the verification of the claims, but may at the request of the trustee in bankruptcy be extended up to one year from the bankruptcy judgment. Pledges or security assignments of bank accounts and certain financial instruments, as well as close-out netting agreements, will still be enforceable immediately despite the opening of bankruptcy.

8.2 Are there any preference periods, clawback rights or other preferential creditors' rights (e.g., tax debts, employees' claims) with respect to the security?

In principle, the day of cessation of payment is the day on which the company is declared bankrupt. Upon certain conditions, the trustee in bankruptcy or any interested third party can request the court to bring that date back up to six months before the date of the bankruptcy order to create a so-called "suspect period". The court will, upon the request of the trustee in bankruptcy, render certain acts of the bankrupt company performed during this period (gifts, sub value contracts, payments (in kind) of undue debts and security interests granted for antecedent debts) unenforceable against the body of creditors (and sometimes it will be obliged to do so).

The court can also declare other acts performed during the "suspect period" unenforceable if the third party was aware of the company's cessation of payments. Finally, any acts or payments, whenever performed, that are to the fraudulent detriment of the creditors, can be declared unenforceable (*actio pauliana*).

8.3 Are there any entities that are excluded from bankruptcy proceedings and, if so, what is the applicable legislation?

Public bodies, and organisations without legal personality and purpose of payment to its members are excluded from bankruptcy proceedings.

8.4 Are there any processes other than court proceedings that are available to a creditor to seize the assets of a company in an enforcement?

Upon certain conditions, the beneficiary of a pledge over financial collateral does not need prior court intervention to directly seize the assets of a company.

9 Jurisdiction and Waiver of Immunity

9.1 Is a party's submission to a foreign jurisdiction legally binding and enforceable under the laws of your jurisdiction?

In principle, a party is allowed to choose any foreign jurisdiction as a forum for its dispute. However, under certain conditions, Belgian courts will have exclusive jurisdiction (e.g. for disputes concerning rights in rem on immovable property located in Belgium). A Belgian court will also be competent if the case is closely tied to Belgium and it would be impossible or unreasonable to bring proceedings before a court of a chosen foreign jurisdiction.

9.2 Is a party's waiver of sovereign immunity legally binding and enforceable under the laws of your jurisdiction?

Immunity can be waived by explicit consent.

10 Licensing

10.1 What are the licensing and other eligibility requirements in your jurisdiction for lenders to a company in your jurisdiction, if any? Are these licensing and eligibility requirements different for a "foreign" lender (i.e. a lender that is not located in your jurisdiction)? In connection with any such requirements, is a distinction made under the laws of your jurisdiction between a lender that is a bank *versus* a lender that is a non-bank? If there are such requirements in your jurisdiction, what are the consequences for a lender that has not satisfied such requirements but has nonetheless made a loan to a company in your jurisdiction? What are the licensing and other eligibility requirements in your jurisdiction for an agent under a syndicated facility for lenders to a company in your jurisdiction?

Under Belgian law, lending money (excluding consumer credit and mortgage backed credit to individuals for residential purposes) is not a regulated activity, provided that the lender does not solicit funds from the public in Belgium. As a result, investors and foreign banks can in principle grant a loan to a Belgian company, without being licensed as a credit institution or a lender.

11 Other Matters

11.1 Are there any other material considerations which should be taken into account by lenders when participating in financings in your jurisdiction?

The new Companies Code will abolish the capital requirements for private limited liability companies.

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astrea

Astrea is one of the leading independent full-service law firms in Belgium, with offices in both Brussels and Antwerp, the two largest economic and financial centres in the country. It currently has 13 partners and approximately 40 fee-earners in total, and an impressive international and domestic client base. The lawyers at Astrea have a very business-oriented, pragmatic and flexible no-nonsense approach, and are known for offering good value.

Astrea has extensive experience in advising Belgian and international companies in the field of financing (including general corporate finance, acquisition finance, real estate financing, project finance, structured finance and asset-based finance) and debt capital market transactions. Astrea's banking & finance team has been involved in several domestic and cross-border transactions, both as borrowers' and lenders' counsel. They work together on a regular basis with international law firms.

Bermuda

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1 Overview

1.1 What are the main trends/significant developments in the lending markets in your jurisdiction?

There were no changes to Bermuda's Companies Act 1981 (**Companies Act**) during 2018 affecting the rights of secured parties or Bermuda's reputation as a leading creditor-friendly jurisdiction.

In the aviation finance sector, effective 1 January 2018, the Cape Town Convention and the related Protocol (Convention) came into force pursuant to the Bermuda International Interests in Mobile Equipment (Cape Town Convention) Act 2016. This ensures Bermuda continues to be at the forefront of, and an attractive jurisdiction for, aviation leasing and refinancing transactions.

In 2018, Bermuda also passed two significant statutes that enhanced its position as a world-leading fintech jurisdiction. The Companies and Limited Liability Company (Initial Coin Offering) Amendment Act 2018 (**ICO Act**), for initial coin offerings, came into force in July 2018 and the Digital Asset Business Act 2018 (**DABA**), for entities carrying on digital asset business from within Bermuda, came into force in October 2018. The ICO Act regulates a company's offering of digital assets such as digital coins and tokens, while the DABA regulates private sales of, and persons engaged in the business of, virtual currencies (including operating electronic exchanges and providing custodial wallet services). Substantial growth in the fintech sector is expected during 2019, which should result in increased activity in the secured lending market.

Bermuda has now implemented a system of land title registration and changes of ownership and/or lending transactions trigger compulsory first registration of the land in question.

1.2 What are some significant lending transactions that have taken place in your jurisdiction in recent years?

The most significant lending transactions that have taken place in 2018 were in financed holding and joint venture structures, which utilised a variety of secured lending arrangements.

One such significant lending transaction in the aviation sector during 2018 was the refinancing of Aircastle Limited (NYSE: AYR), including an increase of its revolving credit facility to USD 800 million, involving a syndicate of lenders including Citibank, Goldman Sachs Bank, J.P. Morgan Chase Bank and Royal Bank of Canada, as joint lead arrangers.

A substantial lending transaction in the oil and gas sector saw Wakefield Quin advising lenders in Seadrill Limited's successful completion of its USD 10 billion comprehensive group restructuring plan following Seadrill's chapter 11 plan of reorganisation.

We continue to see an increase in the use of Bermuda special purpose vehicles in the mining, oil and gas, property development, aviation and shipping sectors.

2 Guarantees

2.1 Can a company guarantee borrowings of one or more other members of its corporate group (see below for questions relating to fraudulent transfer/financial assistance)?

A company may guarantee borrowings of members of its corporate group provided the company has capacity to provide such guarantees and there is a sufficient corporate benefit to the company, which may be in the form of a benefit to the company group.

2.2 Are there enforceability or other concerns (such as director liability) if only a disproportionately small (or no) benefit to the guaranteeing/securing company can be shown?

In these circumstances, there is a risk that the directors are not adequately discharging their fiduciary duties or statutory directors' duties to act honesty and in good faith with a view to the best interests of the company.

In considering whether to approve such a guarantee, the directors would need to satisfy themselves that a sufficient direct, indirect or group commercial benefit exists. If the company is insolvent, the directors may be liable for wrongful trading and there is a risk that the guarantee may be void on the grounds that it amounted to a fraudulent preference.

2.3 Is lack of corporate power an issue?

The constitutional documents of the guarantor company should be reviewed to ensure the company has capacity to give the contemplated guarantee. A company's memorandum of association may not set out an express power to give guarantees; however, in most cases, the company's objects would typically be sufficiently broad to permit the entry into guarantees that are ancillary to the business of the company.

2.4 Are any governmental or other consents or filings, or other formalities (such as shareholder approval), required?

In most cases, no such consents or filings are required unless the company undertakes regulated activity, such as insurance, in which case consent may be required from the Bermuda Monetary Authority (**BMA**).

Guarantees of loans to directors (and other persons related to directors) are generally prohibited without the consent of members holding 90% of the company's voting rights and if such member consent is not obtained, the directors authorising the entering into of the guarantee shall be jointly and severally liable to indemnify the company against any loss arising. Member consent to directors' loans or guarantees can be obtained to mitigate concerns of corporate benefit and breach of fiduciary obligation.

Guarantees are often executed as a deed to avoid disputes concerning due consideration.

2.5 Are net worth, solvency or similar limitations imposed on the amount of a guarantee?

No statutory limitations are imposed; however, directors should consider the solvency of the company and ensure that any guarantee to be granted is in the best interests of the company.

2.6 Are there any exchange control or similar obstacles to enforcement of a guarantee?

There are no exchange control restrictions that would act as an obstacle to the enforcement of a guarantee against a company; however, non-Bermuda exchange control and any applicable international sanctions should be reviewed and considered.

3 Collateral Security

3.1 What types of collateral are available to secure lending obligations?

Both tangible and intangible assets of a company are available to secure lending obligations.

3.2 Is it possible to give asset security by means of a general security agreement or is an agreement required in relation to each type of asset? Briefly, what is the procedure?

In lending transactions, companies typically grant general security agreements, such as debentures, to secure underlying obligations. Where shares of a Bermuda company form part of the asset security, it is usual for a Bermuda law-governed share charge to be used. Specific regimes apply for security over Bermuda land, ships, aircraft and aircraft engines registered in Bermuda.

3.3 Can collateral security be taken over real property (land), plant, machinery and equipment? Briefly, what is the procedure?

Security over real property in Bermuda is typically granted by way of legal or equitable mortgage and by way of fixed charge or chattel mortgage over plant, machinery and equipment.

Different rules apply depending on whether the company is a local or an exempted company. Exempted companies may hold land in Bermuda but only to the extent that the land (a) is designated commercial real estate and used for the company's business purpose, or (b) is residential real estate that will be used to accommodate employees of the company and is generally available to be acquired by non-Bermudians. Land holding permissions are required for both freehold and long leasehold acquisitions and the applicant will need to show both a *bona fide* business need and a benefit to Bermuda (most often the creation of local jobs). Local companies may hold land in Bermuda if specifically permitted under the company's constitutional documents, the Minister of Finance has provided its consent and the company requires the land to carry out its business.

Local and exempted companies may enter into land leases for business purposes for up to 50 years. They may also lease residential premises in the company's name for up to 21 years with Ministerial permission.

A legal mortgage traditionally transferred title to the land to the mortgagee subject to the requirement that the title be transferred to the mortgagor upon satisfaction of the underlying secured obligations. The grant of a mortgage or charge triggers compulsory first registration of the land and both the deed and the title documents must be lodged with the Land Title Registry Office. Once the land is registered the mortgage will be automatically converted to a registered charge on the land. This system replaces registration of the mortgage in the Book of Mortgages. The electronic title register will then replace the title deeds (as evidence of ownership), but most lenders continue to take possession of the title deeds in case there are later challenges to the title. Priority is based on the date the application for first registration is made. Legal mortgages must be executed as a deed whereas equitable charges may be signed under hand. Equitable charges are likely to be phased out as more and more real property is registered. Both mortgages and charges attract stamp duty, generally at the rate of 0.5% of the principal sum secured.

There are special rules that apply if an overseas or exempted company wishes to hold a mortgage over Bermuda land, including obtaining the prior consent of the Ministers of Finance and Immigration. If the mortgage is to be enforced, any land obtained by an overseas or exempted company must be sold within five years to either a person or entity having Bermudian status or another licensed party.

In relation to a fixed charge over plant, machinery and equipment, registration is not necessary in Bermuda to perfect the security interest created. However, to ensure the priority in Bermuda of the charge, the charge must be registered at the Registrar of Companies (**ROC**) and upon registration, to the extent that Bermuda law governs the priority of a charge, such charge will have priority in Bermuda over any unregistered charges and over any subsequently registered charge.

3.4 Can collateral security be taken over receivables? Briefly, what is the procedure? Are debtors required to be notified of the security?

Collateral security can be granted over receivables by way of assignment or fixed or floating charge. Assignments can be legal or equitable. Legal assignments must be in writing, signed by the assignor and unconditional and written notice must be provided to the debtor. An equitable assignment will result if any of these requirements are not satisfied.

Under a legal assignment, the assignee can sue in its own name and the debtor can only discharge its obligations as instructed by the assignee.

Although not legally required to perfect the security interest, assignments and charges over receivables should be registered with the ROC to ensure priority.

3.5 Can collateral security be taken over cash deposited in bank accounts? Briefly, what is the procedure?

Companies may grant security over cash in its bank accounts which is typically effected by way of a fixed or floating charge. The amount of control that the chargee will have over the account will determine whether a charge is fixed or floating.

Serving notice on a bank will ensure a chargee's priority in relation to subsequent assignees provided the chargee has no knowledge of an earlier assignment. Service of notice on a bank will perfect the security granted by the chargor regardless of whether or not the bank provides an acknowledgement.

Bermuda banks typically require chargees and chargors to enter into a deposit account control agreement to regulate the administration of the account, including restricting withdrawals unless permitted by the chargee and the banks' agreement not to exercise set-off rights.

Although not legally required to perfect the security interest, charges over accounts should be registered with the ROC to ensure priority.

3.6 Can collateral security be taken over shares in companies incorporated in your jurisdiction? Are the shares in certificated form? Can such security validly be granted under a New York or English law governed document? Briefly, what is the procedure?

Security over shares of Bermuda companies is typically granted by way of a share charge. Legal mortgages are uncommon, although share charges usually provide the chargee with the right to create a legal mortgage upon the occurrence of certain events. It is recommended that chargors also be required to deliver certain ancillary documents to strengthen their security, including executed but undated share transfer forms, irrevocable voting proxies and undertakings.

Bermuda companies cannot issue bearer shares. Share certificates do not need to be issued unless required under the company's bye-laws or requested by a shareholder; if issued, share certificates are generally a deliverable under a charge over shares of a Bermuda company.

For efficacy of enforcement, it is recommended that share charges be governed by Bermuda law. However, it is possible for New York or English law to govern the charge if required by the underlying transaction documents.

Bermuda exchange control regulations generally require the consent of the BMA prior to any disposition of shares of a Bermuda company, which would include the creation of a security interest. The BMA has granted a blanket consent where the chargee is a licensed bank or lending institution in certain appointed jurisdictions and the BMA is provided with written notification.

Although not legally required to perfect the security interest, share charges should be registered with the ROC to ensure priority.

3.7 Can security be taken over inventory? Briefly, what is the procedure?

Security is typically taken over inventory by means of a floating charge, due to the fluctuating nature of inventory.

Although not legally required to perfect the security interest, a floating charge should be registered with the ROC to ensure priority.

3.8 Can a company grant a security interest in order to secure its obligations (i) as a borrower under a credit facility, and (ii) as a guarantor of the obligations of other borrowers and/or guarantors of obligations under a credit facility (see below for questions relating to the giving of guarantees and financial assistance)?

There should be no issues in any of these situations, provided there is a demonstrable corporate benefit to the company (which may be in the form of a benefit to the company group, if applicable) and the company is solvent.

3.9 What are the notarisation, registration, stamp duty and other fees (whether related to property value or otherwise) in relation to security over different types of assets?

Stamp duty rarely applies to documents that are executed by Bermuda companies engaged in international business. However, legal mortgages on Bermuda real estate do attract stamp duty at different rates depending on the amount of the sum secured.

With limited exceptions, stamp duty is payable on most documents executed by local Bermuda companies.

A fee of between $380 and $665 will be payable for registering a charge at the ROC, depending on the value secured. There is also a $95 fee for registering a satisfaction of a charge at the ROC.

A fee of between $100 and $1,300 is payable to the Land Title Registry Office on the first registration of real property. Thereafter, a fee of between $50 and $400 is levied to register a charge against a registered title.

3.10 Do the filing, notification or registration requirements in relation to security over different types of assets involve a significant amount of time or expense?

Security arrangements can be registered in Bermuda on a same-day basis. Certain prescribed forms need to be filed; however, Bermuda counsel can attend to these requirements.

If a chargee is taking security over shares in a Bermuda company and the chargee is not a licensed bank or lending institution and is not known to the BMA, the BMA may require a few working days to provide its consent to the granting of the charge for exchange control purposes.

3.11 Are any regulatory or similar consents required with respect to the creation of security?

Generally, other than for BMA consent that may be required for exchange control purposes, no regulatory or similar consent is typically required for companies to grant security over their assets.

3.12 If the borrowings to be secured are under a revolving credit facility, are there any special priority or other concerns?

Generally, no.

3.13 Are there particular documentary or execution requirements (notarisation, execution under power of attorney, counterparts, deeds)?

Secured parties will want to receive copies of authorisation board resolutions to ensure corporate formalities have been followed and issues regarding corporate benefit have been considered.

Special rules apply for deeds, including that the deed be in writing, that it was intended to be executed as a deed and that the deed was validly executed as a deed in accordance with the company's bye-laws.

In most cases, powers of attorney must be executed as a deed.

4 Financial Assistance

4.1 Are there prohibitions or restrictions on the ability of a company to guarantee and/or give security to support borrowings incurred to finance or refinance the direct or indirect acquisition of: (a) shares of the company; (b) shares of any company which directly or indirectly owns shares in the company; or (c) shares in a sister subsidiary?

There is no general prohibition or restriction on financial assistance, but loans to directors or security in favour of director loans (or loans to persons connected to a director) are restricted.

(a) Shares of the company

Without the consent of the members of the company holding shares with 90% of the voting rights, it is unlawful for a company to make a loan, enter into a guarantee or provide security in connection with a loan to a director (or to certain persons connected with a director) except in certain limited circumstances.

(b) Shares of any company which directly or indirectly owns shares in the company

See question 4.1 above.

(c) Shares in a sister subsidiary

See question 4.1 above.

5 Syndicated Lending/Agency/Trustee/Transfers

5.1 Will your jurisdiction recognise the role of an agent or trustee and allow the agent or trustee (rather than each lender acting separately) to enforce the loan documentation and collateral security and to apply the proceeds from the collateral to the claims of all the lenders?

A Bermuda court would recognise the role of a security agent or trustee and allow the agent or trustee to enforce the loan documentation and collateral security and to apply the proceeds from the collateral to the claims of all the lenders pursuant to the terms of the intercreditor, loan and security documentation.

5.2 If an agent or trustee is not recognised in your jurisdiction, is an alternative mechanism available to achieve the effect referred to above which would allow one party to enforce claims on behalf of all the lenders so that individual lenders do not need to enforce their security separately?

Agency and trustee relationships are well established in Bermuda.

5.3 Assume a loan is made to a company organised under the laws of your jurisdiction and guaranteed by a guarantor organised under the laws of your jurisdiction. If such loan is transferred by Lender A to Lender B, are there any special requirements necessary to make the loan and guarantee enforceable by Lender B?

There are no special requirements to make the loan and guarantee enforceable by Lender B so long as the transfer or novation procedures are complied with pursuant to the terms of the loan documentation.

6 Withholding, Stamp and Other Taxes; Notarial and Other Costs

6.1 Are there any requirements to deduct or withhold tax from (a) interest payable on loans made to domestic or foreign lenders, or (b) the proceeds of a claim under a guarantee or the proceeds of enforcing security?

Bermuda has no income, corporate, withholding or capital gains tax and no estate duty or inheritance tax. No such taxes or duty are payable to any authority in Bermuda whether on loan interest or proceeds of claim.

6.2 What tax incentives or other incentives are provided preferentially to foreign lenders? What taxes apply to foreign lenders with respect to their loans, mortgages or other security documents, either for the purposes of effectiveness or registration?

There are no tax incentives. Foreign lenders will not be deemed to be resident, domiciled or carrying on business in Bermuda by reason only of the execution, performance and/or enforcement of the loan and security documents.

6.3 Will any income of a foreign lender become taxable in your jurisdiction solely because of a loan to, or guarantee and/or grant of, security from a company in your jurisdiction?

No income of a foreign lender will become taxable in Bermuda solely because of a loan to or guarantee and/or grant of security from a Bermuda company.

6.4 Will there be any other significant costs which would be incurred by foreign lenders in the grant of such loan/guarantee/security, such as notarial fees, etc.?

Generally, no. Neither notarisation nor registration is necessary to perfect a security interest, but registration with the ROC (for which fees are payable, see question 3.9 above) confers priority ranking over subsequent registered security interests.

6.5 Are there any adverse consequences for a company that is a borrower (such as under thin capitalisation principles) if some or all of the lenders are organised under the laws of a jurisdiction other than your own? Please disregard withholding tax concerns for purposes of this question.

Generally, no.

7 Judicial Enforcement

7.1 Will the courts in your jurisdiction recognise a governing law in a contract that is the law of another jurisdiction (a "foreign governing law")? Will courts in your jurisdiction enforce a contract that has a foreign governing law?

In proceedings to enforce the obligations of a Bermuda company, Bermuda courts generally would give effect to the choice of foreign law as the governing law of the contract, provided that: (i) the point is specifically pleaded; (ii) the choice of law is valid and binding under foreign law; and (iii) recognition would not be contrary to public policy as that term is understood under Bermuda law. Where the foreign governing law is the laws of England and Wales, Bermuda courts are well-practised in enforcing such contracts. Not only are English court judgments automatically enforceable in certain circumstances (see question 7.2 below), but Bermuda courts regularly refer to persuasive English case law, and the ultimate court of appeal in Bermuda is the UK Privy Council.

7.2 Will the courts in your jurisdiction recognise and enforce a judgment given against a company in New York courts or English courts (a "foreign judgment") without re-examination of the merits of the case?

A final and conclusive judgment in the New York courts against a Bermuda company, based on a contract under which a sum of money is payable (not being in respect of multiple damages, or a fine, penalty, tax or other charge of similar nature) (**a Money Claim**), may be enforced in Bermuda under the common law doctrine of obligation for the debt evidenced by the New York court judgment. When considering whether a New York court judgment should be recognised and enforced, such proceeding would likely be successful provided that (a) the New York court was competent to hear the action in accordance with private international law principles as applied in Bermuda, and (b) the judgment is not contrary to public policy in Bermuda, has not been obtained by fraud, or in proceedings contrary to natural justice and is not based on an error in Bermuda law.

A final and conclusive judgment in the superior courts of England against a Bermuda company, based on a Money Claim would, on registration in accordance with the Judgments (Reciprocal Enforcement) Act 1958, be enforceable in Bermuda without the necessity of any retrial of issues or any re-examination of underlying claims, provided that the judgment: (a) is final and conclusive (notwithstanding that any appeal may be pending against it or it may be still subject to an appeal in England); (b) has not been given on an appeal from a court in England which is not a superior court in England; and (c) is duly registered in the Supreme Court of Bermuda.

Additionally, a foreign judgment against a Bermuda company may form the basis of a statutory demand, even if the judgment has not been registered as a judgment under Bermuda law, provided that the jurisdiction of the foreign court is not disputed on genuine grounds. Non-payment of the statutory demand would be sufficient for the secured creditor to seek commencement of liquidation proceedings.

Where a foreign judgment is expressed in a currency other than Bermuda dollars, the registration will involve the conversion of the judgment debt into Bermuda dollars on the basis of the exchange rate prevailing at the date of the judgment. The current policy of the BMA is to permit payment in the original judgment currency.

7.3 Assuming a company is in payment default under a loan agreement or a guarantee agreement and has no legal defence to payment, approximately how long would it take for a foreign lender to (a) assuming the answer to question 7.1 is yes, file a suit against the company in a court in your jurisdiction, obtain a judgment, and enforce the judgment against the assets of the company, and (b) assuming the answer to question 7.2 is yes, enforce a foreign judgment in a court in your jurisdiction against the assets of the company?

Bermuda maintains a separate Commercial Court division of its Supreme Court, with judges experienced in commercial matters.

A commercial claim is commenced by issuing a writ of summons in the Registry of the Supreme Court, endorsed with a statement of claim and the relief sought. A Bermuda company respondent generally has 14 days to submit and file a response or contest the jurisdiction of the Bermuda court. It is possible for a suit to be filed and judgment obtained within a few weeks.

If jurisdiction is contested or the respondent disputes the matters which form the statement of claim, the appellant is entitled to respond and proceedings can be prolonged in a similar fashion as they may be in other common law jurisdictions.

If satisfied that a foreign judgment fulfils the requirements for registration, a Bermuda court will register the judgment as a matter of course. However, actual enforcement cannot proceed until the expiry of the judgment debtor's allotted time for challenging registration or any challenge has been determined. Foreign lenders may request summary judgments, interim judgments, costs awards and injunctions, such as Mareva and interlocutory injunctions, which can be obtained on a "same day" basis to prevent dispersal of assets.

7.4 With respect to enforcing collateral security, are there any significant restrictions which may impact the timing and value of enforcement, such as (a) a requirement for a public auction, or (b) regulatory consents?

There are no significant enforcement restrictions under Bermuda law. Most foreign judgment creditors seek the appointment of a receiver, to assist with gathering and realising the assets of a defaulting debtor and speed up the process, or seek to liquidate the defaulting debtor and engage liquidators to undertake collateral realisation.

Additionally, it may be possible to obtain a Bermuda writ of sequestration to have sequestrators appointed to take charge of all the defendant's assets until the defendant complies with the judgment.

There are restrictions in Bermuda regarding the ownership of land and real estate (see question 3.3 above) and shares of a Bermuda company (see question 3.6 above), which may require prior authorisation from Bermuda authorities.

7.5 Do restrictions apply to foreign lenders in the event of (a) filing suit against a company in your jurisdiction, or (b) foreclosure on collateral security?

There are no specific restrictions applicable to foreign lenders in the event of filing suit against a Bermuda company or otherwise applicable to foreclosure on collateral security. However, most foreign lenders prefer to appoint receivers or provisional liquidators to assist with the realisation of assets or foreclosure of collateral security.

7.6 Do the bankruptcy, reorganisation or similar laws in your jurisdiction provide for any kind of moratorium on enforcement of lender claims? If so, does the moratorium apply to the enforcement of collateral security?

After the presentation of a winding-up petition, the Bermuda company or any of its creditors may apply to the Bermuda court for a stay of proceedings.

No moratoriums apply to the enforcement of collateral security, as secured parties generally operate outside of Bermuda's bankruptcy regime.

7.7 Will the courts in your jurisdiction recognise and enforce an arbitral award given against the company without re-examination of the merits?

Bermuda is a party to the New York Convention on the Recognition and Enforcement of Foreign Arbitral Awards and recognises awards made under arbitration agreements in a foreign jurisdiction that is also party to the New York Convention. If a foreign arbitral award is given against a defaulting debtor company as a result of arbitration in a "convention" jurisdiction, Bermuda's International Conciliation and Arbitration Act 1993 (**ICCA**) provides that the award may be enforced in Bermuda either by action or, with leave from the court, in the same way as a judgment or order to the same effect. The enforcing party must make an application for leave (with or without notice) under section 48 of the ICAA, regardless of the jurisdiction in which the award was made and (where leave is given) judgment can be entered in terms of the award, without re-examination of its merits.

On an *ex parte* application where leave has been granted to enforce the award, the order will not allow enforcement until the other party has 14 days to respond and bring an application to set the award aside. The 14-day response period is increased in certain circumstances.

8 Bankruptcy Proceedings

8.1 How does a bankruptcy proceeding in respect of a company affect the ability of a lender to enforce its rights as a secured party over the collateral security?

Bankruptcy proceedings against a Bermuda company may affect the ability of a lender to enforce its rights as underlying transactions may be attacked. See question 8.2 below.

8.2 Are there any preference periods, clawback rights or other preferential creditors' rights (e.g., tax debts, employees' claims) with respect to the security?

Any conveyance or other disposition of property made by or against a Bermuda company within six months prior to the commencement of its winding up will be invalid if it was made with the intent to fraudulently prefer one or more of such company's creditors at a time that the company was unable to pay its debts as they became due.

Under the fraudulent conveyance provisions of the Conveyancing Act 1983, a creditor may seek to set aside a disposition of property (including the creation of a security interest) if the disposition was made in circumstances where the transferor's dominant purpose was to put the property beyond the reach of a person (or class of persons) who is making, or may make, a claim against the transferor and the disposition was at an undervalue. Such a claim can only be made by an "eligible creditor", which is a person who: (i) is owed a debt by the transferor within two years after the disposition; (ii) on the date of the disposition is owed a contingent liability by the transferor, where the contingency giving rise to the obligation has occurred; or (iii) on the date of the action to set aside the disposition, is owed an obligation arising from a cause of action which occurred prior to or within two years after the date of the transfer.

In relation to floating charges, where a Bermuda company is being wound up, a floating charge on the undertaking or property of the Bermuda company created within 12 months of the commencement of the winding up will, unless it is proved that such Bermuda company immediately after the creation of the charge was solvent, be invalid, except to the amount of any cash paid to such Bermuda company at the time of or subsequently to the creation of, and in consideration for, the charge, together with interest on that amount at the statutory rate.

Certain debts are preferred by statute but only over (i) claims of unsecured creditors, and (ii) claims of secured creditors who are holders of floating charges. In a winding up of a Bermuda company, debts secured by fixed charges retain first priority, followed by: (a) all taxes owing to the Bermuda government and rates owing to a municipality; (b) all wages or salary (up to a maximum of BD$2,500 in respect of any one claimant) of any employee for services rendered to the company during the four months before the winding up; (c) all accrued holiday remuneration payable to any employee on termination of his employment before or following the winding up; (d) certain amounts due by the company as employer of any persons under the Contributory Pensions Act 1970 or any contract of insurance; (e) certain amounts due in respect of any liability for compensation under the Workmen's Compensation Act 1965, being amounts which have accrued before the winding up; (f) secured creditors under floating charges; and (g) unsecured creditors.

8.3 Are there any entities that are excluded from bankruptcy proceedings and, if so, what is the applicable legislation?

Generally, the winding-up and insolvency provisions in the Companies Act apply to all Bermuda companies. Licensed Bermuda banks are governed by a separate insolvency regime under the Banking (Special Resolution Regime) Act 2016, which has been passed but has not yet been brought into effect.

8.4 Are there any processes other than court proceedings that are available to a creditor to seize the assets of a company in an enforcement?

The remedies available to a creditor would generally be set out in the loan and security documents and would include exercising the power of sale, taking possession of assets and appointing a receiver.

Creditors can also reorganise, or reach a compromise with, a Bermuda company under a scheme of arrangement, provided that the scheme is approved by the company and a supermajority of its creditors. Although a scheme will bind all creditors (or class of creditors), it must be sanctioned by the Bermuda court to be effective.

9 Jurisdiction and Waiver of Immunity

9.1 Is a party's submission to a foreign jurisdiction legally binding and enforceable under the laws of your jurisdiction?

The submission by a Bermuda company to the jurisdiction of a foreign court under a loan or security agreement would be recognised by a Bermuda court as a legal, valid and binding submission to the jurisdiction of the foreign court, provided that such submission is accepted by the foreign court and is legal, valid and binding under such foreign law.

9.2 Is a party's waiver of sovereign immunity legally binding and enforceable under the laws of your jurisdiction?

Yes, both private and public Bermuda companies can validly waive any claim of sovereign immunity.

10 Licensing

10.1 What are the licensing and other eligibility requirements in your jurisdiction for lenders to a company in your jurisdiction, if any? Are these licensing and eligibility requirements different for a "foreign" lender (i.e. a lender that is not located in your jurisdiction)? In connection with any such requirements, is a distinction made under the laws of your jurisdiction between a lender that is a bank *versus* a lender that is a non-bank? If there are such requirements in your jurisdiction, what are the consequences for a lender that has not satisfied such requirements but has nonetheless made a loan to a company in your jurisdiction? What are the licensing and other eligibility requirements in your jurisdiction for an agent under a syndicated facility for lenders to a company in your jurisdiction?

Foreign lenders, and foreign agents and trustees under syndicated facilities, do not need to be licensed in Bermuda to undertake lending business with Bermuda companies, unless they are otherwise carrying on business within Bermuda.

11 Other Matters

11.1 Are there any other material considerations which should be taken into account by lenders when participating in financings in your jurisdiction?

The information included in this chapter cover the key issues to be considered in secured lending transactions in Bermuda. Specific advice should be sought from Bermuda counsel at the earliest opportunity to ensure security is effective and readily enforceable in Bermuda.

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Chapter 35

Bolivia


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1 Overview

1.1 What are the main trends/significant developments in the lending markets in your jurisdiction?

In 2014, several changes regarding financial intermediaries were established by the Financial Services Law, with the objective of creating specialised bodies and aiming to have a stronger government presence in this specific area by means of a regulatory entity. In early July 2014, specific regulations were issued in order to establish loan rates that must be applied by financial intermediaries, especially for lending transactions completed in the industry sector and for social housing loans. These specific regulations are expected to allow portfolio growth in priority sectors defined by the national government, specifically production credits and access to social housing. As of the beginning of the implementation of these changes at the end of 2018, Bolivian financial entities have reported an achievement in the goals settled by the laws and regulations.

Since 2014, very few changes regarding financial loans and credits have been made in Bolivia. However, among the main changes and trends in this regard in Bolivia, we should mention:

(a) The creation of a guarantee fund for production credits (as of the issuance of Supreme Decree 2136 (dated 9 October 2014) and Supreme Decree 2614 (dated 2 December 2015)), by which the Central Bank of Bolivia created the aforementioned guarantee fund as a hedge mechanism for production microcredits and credits granted by financial entities in Bolivia. This guarantee fund is based on a percentage of the annual net incomes of multiple banks in Bolivia.

(b) The creation of a guarantee fund for social housing loans (as of the issuance of Supreme Decree 2137 (dated 9 October 2014)), by which the Central Bank of Bolivia created the aforementioned guarantee fund as a hedge mechanism for loans granted to people who intend to buy their first home. This guarantee fund is also based on a percentage of the annual net incomes of multiple banks in Bolivia.

(c) The recent creation of a non-conventional guarantee form, for the acceptance of construction progress worksheets that are pending payment, duly signed by a construction auditor. This new guarantee aims to promote credits granted to the construction sector exclusively for public work constructions, which also belong to the production credits category that has been promoted by the Bolivian government since the issuance, in 2014, of new financial legal measures. The acceptance of construction progress worksheets as a guarantee has been regulated by Supreme Decree 3722, issued on 21 December 2018.

1.2 What are some significant lending transactions that have taken place in your jurisdiction in recent years?

The Bolivian Financial Services Law distinguishes three types of financial institutions: (i) State-owned or State-controlled financial institutions, which include (a) development banks, (b) public banks, and (c) financial development institutions; (ii) private financial institutions, which include (a) private development banks, (b) private banks, (c) small and medium companies-focused banks, (d) savings and loans cooperatives, (e) housing loans-focused financial institutions, (f) financial development institutions and (g) rural communities financial institutions; and (iii) complementary financial services companies, which include (a) leasing companies, (b) factoring companies, (c) warrant companies, (d) clearing houses, (e) financial information bureaus, (f) money transferal companies, (g) electronic cards administration companies, (h) money exchange companies, and (i) mobile transfer or payment companies.

At the beginning of the fourth quarter of 2018, the financial intermediation system in Bolivia remained stable, with good levels of financial performance as a result of continued deposits and loan portfolio growth, accompanied by low levels of credit defaults and adequate patrimonial support.

Public deposits closed at a balance of US$ 23,369,540, an increase of US$ 572,988 compared to 2017.

Loans Portfolio

Until December 2017, the loans portfolio closed at US$ 24,037,643, an increase of US$ 2,189,799 compared to the end of 2017.

Industrial, Commercial and Services Sector Portfolios

Up until December 2018, the loan portfolio for the industry sector, which comprises entrepreneurs' credits, micro credits and SMEs credits for all types of activities and industries (such as agriculture, cattle raising, forestry and fishing, extraction of crude oil and natural gas, metallic and non-metallic mineral mining, manufacturing, electricity, gas, water and construction) amounts to US$ 10,583,333.

Social Housing Sector Portfolio

The Financial Services Law of Bolivia No. 393 dated 21 August 2013, introduced Social Interest Housing loans as a new category for bank loans, which is targeted at middle income families or individuals that want to buy or build their first house or apartment. One of the main conditions required in order to apply for this type of loan is that the cost of said house must not exceed the US$ 120,000 price barrier, or US$ 100,000 in the case of apartments.

This particular type of loan has a State-regulated fixed interest rate, which can only vary from 5.5% to 6.5%, depending on the amount of the specific loan.

Another particular characteristic of this type of loan is that no down payment or guarantee is required. In order to guarantee these loans, the Bolivian government issued a regulation that forces private banks to invest 6% of their annual earnings into special guarantee funds created by them for that sole purpose.

As of December 2018, the social housing sector portfolio in Bolivia reached US$ 2,906,465.

2 Guarantees

2.1 Can a company guarantee borrowings of one or more other members of its corporate group (see below for questions relating to fraudulent transfer/financial assistance)?

In Bolivia, it is very common for companies within a corporate group to secure loans from one or more other members of its corporate group. On the other hand, companies that belong to financial groups are prohibited from securing loans unless they are companies dedicated to investments.

2.2 Are there enforceability or other concerns (such as director liability) if only a disproportionately small (or no) benefit to the guaranteeing/securing company can be shown?

If the company is dedicated to guaranteeing investment, the responsibility lies with those who have approved the transaction. In general, however, directors also have responsibility as the operation is guaranteed by the goods of the company.

If the directors of a company ensure an operation and such directors do not have the authority to perform such act, they are also responsible for their own assets.

2.3 Is lack of corporate power an issue?

Indeed; the lack of authority enabling a person or persons to act on behalf of a company is a grave and a serious problem. There are certain powers that enable people to carry out the activities and business of a company, and any person who acts without such authority is liable to penalties which are provided by law. All further acts performed by those people and the company might be void or voidable.

2.4 Are any governmental or other consents or filings, or other formalities (such as shareholder approval), required?

Bolivian law does not provide for State authorisation and credit approval for the creation of securities, except concerning State-owned companies.

However, when a company applies for a loan, the application must have the appropriate support, such as financial analysis of the company demonstrating the need for a loan, and, overall, approval of the shareholders of the company.

In the stock market, it is necessary to have the approval of the shareholders in order to issue bonds.

For the granting of guarantees, such guarantees must be fully sanitised and free from all liens. If the security has a lien, the creditor will require permission for the property to be used as security for other creditors.

2.5 Are net worth, solvency or similar limitations imposed on the amount of a guarantee?

It depends on the amount requested. If the company has some financial indicators that are not in line with the credit policy of the entity, it may request the granting of additional collateral to support the operation.

2.6 Are there any exchange control or similar obstacles to enforcement of a guarantee?

For the enforcement of a guarantee there are no exchange controls in Bolivia. The main obstacle is the time it takes to enforce a guarantee in the judicial system; such time frame depends on the individual case (please see the answers in section 8).

For the enforcement of a security with no exchange controls, the obstacles encountered are the extended time frames required for the judicial system and the processing of its guarantees.

3 Collateral Security

3.1 What types of collateral are available to secure lending obligations?

In Bolivia, lending obligations are secured by mortgages, collateral and unsecured personal guarantees. As of December 2018, lending obligations granted for public work constructions can be guaranteed by means of construction progress worksheets that are pending payment and duly signed by a construction auditor (see the answer to question 1.1).

3.2 Is it possible to give asset security by means of a general security agreement or is an agreement required in relation to each type of asset? Briefly, what is the procedure?

The creation of securities depends on the type of loan requested. The procedure is to sign a contract, and each contract must be guaranteed. The contract also specifies the kind of guarantee given by the borrower, its characteristics, its value, its usefulness and for how long the collateral will be in force.

3.3 Can collateral security be taken over real property (land), plant, machinery and equipment? Briefly, what is the procedure?

Yes, it can. Once the loan has been approved, the borrower delivers all relevant documents pertaining to the guarantee. These documents remain in the custody of the lender, which is usually a bank. The appropriate authorities then keep track of whether the property is collateral for a bank or institutional lender. However, this does not mean that the borrower transfers his ownership of the property to the bank, except where there is breach of property ownership, in which case it may be transferred to third parties to honour the debt.

3.4 Can collateral security be taken over receivables? Briefly, what is the procedure? Are debtors required to be notified of the security?

Bolivian law does not provide for this.

3.5 Can collateral security be taken over cash deposited in bank accounts? Briefly, what is the procedure?

Generally not, but most loan agreements in Bolivia provide that the borrower has to keep a bank account where there is enough money to cover the monthly loan instalments; if the account is declared to have no money, the bank has the power to debit the money from other accounts that the borrower may have with the same bank, after communicating these actions to the debtor.

3.6 Can collateral security be taken over shares in companies incorporated in your jurisdiction? Are the shares in certificated form? Can such security validly be granted under a New York or English law-governed document? Briefly, what is the procedure?

Bolivian law does not allow companies to give its shares in warranty as in other countries. What is usually done is that the shareholders of a company must agree to be guarantors of the credit operations of the company and they guarantee the loan with their shares.

In Bolivia, shares have to be issued certificates and such certificates must be registered in the books of the company's shareholders.

As part of a loan agreement, a clause allowing the resolution of disputes and enforcement of a security to be resolved under the laws of another country may be included. This is not a usual practice in Bolivia, but it is allowed, depending on the terms of the agreement between parties.

3.7 Can security be taken over inventory? Briefly, what is the procedure?

Yes, it can. Collateral may be taken over goods in process, finished goods or raw materials. The debtor must request a warrant from the company storing the materials. The bank has control of such materials and each time the debtor needs to access the materials it has to apply for the bank's authorisation. Therefore, the bank has control over the debtor's production and is satisfied that the debtor will honour its debt.

3.8 Can a company grant a security interest in order to secure its obligations (i) as a borrower under a credit facility, and (ii) as a guarantor of the obligations of other borrowers and/or guarantors of obligations under a credit facility (see below for questions relating to the giving of guarantees and financial assistance)?

No it cannot. In Bolivia, this is regulated by the Supervisory Authority of the Financial System (ASFI) and is punishable under the law.

3.9 What are the notarisation, registration, stamp duty and other fees (whether related to property value or otherwise) in relation to security over different types of assets?

Notary fees on guarantees are 4/1,000 of the loan amount for warranty registration in the office of property rights. Further legal costs of around US$ 150 also apply, along with the cost of registration at the Commercial Register in Bolivia, which is US$ 25.

3.10 Do the filing, notification or registration requirements in relation to security over different types of assets involve a significant amount of time or expense?

For the registration of a guarantee, on average a time period of 30 to 45 days is required. On top of this, notary processes will also take between 10 and 15 days. A total of 60 days, on average, is required, and the costs vary in relation to the amount of each loan.

3.11 Are any regulatory or similar consents required with respect to the creation of security?

No regulatory or similar consents are required for the creation of a security.

3.12 If the borrowings to be secured are under a revolving credit facility, are there any special priority or other concerns?

The priority on the enforcement of a guarantee is given by the number of loans that were requested in that line, taking into account that the line of credit has a limit and that limit defines how many loans can be requested. This also dictates if the warranty covers all of the borrowing in that line of credit.

The priority is given predominantly by the order in which the loans were requested; if the guarantee is executed, the amount collected will first cover the oldest operations and then operations that were requested at a later date.

3.13 Are there particular documentary or execution requirements (notarisation, execution under power of attorney, counterparts, deeds)?

For the enforcement of a security, financial institutions have to give their representatives power of attorney, enabling them to pursue the enforcement of the security. These powers must be registered in the Commercial Registry of Bolivia, which is also responsible for their validation.

4 Financial Assistance

4.1 Are there prohibitions or restrictions on the ability of a company to guarantee and/or give security to support borrowings incurred to finance or refinance the direct or indirect acquisition of: (a) shares of the company; (b) shares of any company which directly or indirectly owns shares in the company; or (c) shares in a sister subsidiary?

(a) Shares of the company

In Bolivia, it is expressly forbidden by law for a company to acquire its own shares.

(b) Shares of any company which directly or indirectly owns shares in the company

Cross shareholding is not legally possible in Bolivia.

(c) Shares in a sister subsidiary

Bolivian law does not provide any restrictions in this case.

5 Syndicated Lending/Agency/Trustee/Transfers

5.1 Will your jurisdiction recognise the role of an agent or trustee and allow the agent or trustee (rather than each lender acting separately) to enforce the loan documentation and collateral security and to apply the proceeds from the collateral to the claims of all the lenders?

In Bolivia, the law does not prohibit the role of an agent or trustee and thus its capacity to enforce the loan documentation and collateral security and to apply the proceeds from the collateral to the claims of a group of lenders of the same borrower.

The Bolivian Civil Code states that all of the assets of a multiple debtor constitute their common guarantee.

5.2 If an agent or trustee is not recognised in your jurisdiction, is an alternative mechanism available to achieve the effect referred to above which would allow one party to enforce claims on behalf of all the lenders so that individual lenders do not need to enforce their security separately?

In Bolivia, agents are recognised as long as they have a written legal mandate from the lenders, so they are responsible for performing the collection and enforcement of security granted by banks to borrowers. This does not mean, however, a transfer of the portfolio of the banks to the agent.

5.3 Assume a loan is made to a company organised under the laws of your jurisdiction and guaranteed by a guarantor organised under the laws of your jurisdiction. If such loan is transferred by Lender A to Lender B, are there any special requirements necessary to make the loan and guarantee enforceable by Lender B?

No, there are not, because the lender has cancelled the amount due. The requirement for this transfer is that Lender A has to lift the lien on the collateral, so that Lender B can record the loan and have the right to charge his debt and the guarantee.

6 Withholding, Stamp and Other Taxes; Notarial and Other Costs

6.1 Are there any requirements to deduct or withhold tax from (a) interest payable on loans made to domestic or foreign lenders, or (b) the proceeds of a claim under a guarantee or the proceeds of enforcing security?

No, there are not, since the legislation does not provide this figure, the only thing that sets the tax law is that, if a borrower is foreign, payments made by the debtor for interest are taxed at a rate of 12.5%, as long as the loan agreement was signed in Bolivia. If a loan agreement was not signed in Bolivia, the rate of 12.5% applies to the total amount, including the debt amount and its interest, as it is considered a remittance abroad.

The debtor is liable to pay agent retention and replacement of tax liability.

6.2 What tax incentives or other incentives are provided preferentially to foreign lenders? What taxes apply to foreign lenders with respect to their loans, mortgages or other security documents, either for the purposes of effectiveness or registration?

Bolivian tax legislation does not provide any tax incentives or benefits; the taxes that apply are detailed in question 6.1.

6.3 Will any income of a foreign lender become taxable in your jurisdiction solely because of a loan to, or guarantee and/or grant of, security from a company in your jurisdiction?

Applicable taxes are detailed in question 6.1.

6.4 Will there be any other significant costs which would be incurred by foreign lenders in the grant of such loan/guarantee/security, such as notarial fees, etc.?

No, there will not, just those listed in question 3.9.

6.5 Are there any adverse consequences for a company that is a borrower (such as under thin capitalisation principles) if some or all of the lenders are organised under the laws of a jurisdiction other than your own? Please disregard withholding tax concerns for purposes of this question.

If the loan agreement is made under the laws of a foreign country (e.g. USA), and under such legislation consequences exist for lenders, such adverse consequences apply in Bolivia.

On the contrary, if the loan is carried out under Bolivian legislation, there are no consequences because Bolivia does not have experience and jurisprudence in such cases.

7 Judicial Enforcement

7.1 Will the courts in your jurisdiction recognise a governing law in a contract that is the law of another jurisdiction (a "foreign governing law")? Will courts in your jurisdiction enforce a contract that has a foreign governing law?

Bolivian courts recognise and enforce contracts subject to foreign law, provided they contain two elements: first, that the benefits arising out of these contracts are to be utilised in Bolivia; and second, that the foreign law under which the contract was created is not contrary to Bolivian laws.

7.2 Will the courts in your jurisdiction recognise and enforce a judgment given against a company in New York courts or English courts (a "foreign judgment") without re-examination of the merits of the case?

The courts in Bolivia execute foreign judgments as long as there is a treaty in place with the country concerned. Following the principle of reciprocity, and in the absence of treaties on the matter, Bolivian courts will grant these judgments the same force that the nation in question gives to Bolivian judgments. However, if a foreign judgment was enforceable, it would be necessary to follow a procedure in which the concerned party must seek the enforcement of the judgment at the Supreme Court, and later request the answers of the other party within 10 days. With or without such answers, and after a fiscal opinion (which involves additional time), the court will determine whether or not to enforce the judgment. The enforcement of the judgment shall correspond to the tribunal which would have been the case at first instance in Bolivia.

The new Bolivian Procedure Code (which has come fully into force in February 2016) maintains the same principles and procedure on this matter that were established in the previous Procedure Code. However, it specifies that even though it is not necessary for courts in Bolivia to re-examine the merits of the case, it is necessary for the Supreme Court to recognise the foreign judgment (to determine whether the judgment meets the requirements and procedural basic principles) in order to proceed to its execution (only if the judgment concerns the compliance of an obligation or if it is the intention of a party to validate its probative effects).

7.3 Assuming a company is in payment default under a loan agreement or a guarantee agreement and has no legal defence to payment, approximately how long would it take for a foreign lender to (a) assuming the answer to question 7.1 is yes, file a suit against the company in a court in your jurisdiction, obtain a judgment, and enforce the judgment against the assets of the company, and (b) assuming the answer to question 7.2 is yes, enforce a foreign judgment in a court in your jurisdiction against the assets of the company?

A suit for non-payment can be filed as soon as the deadline the parties have agreed has expired. Generally, it will be possible to act by the way of an executive process, which is quite quick (the suit is filed, the judge examines the procedural requirements of executive judgment, and if appropriate he shall issue a formal notice to be fulfilled within three days, besides having the injunction of the debtor's assets). The executive process should take about one to two months (depending on which exceptions shall be made, also counting the evidence term which will take 10 additional days). In case the loan agreement included a waiver clause regarding the executive procedure, the obligation may also be required by way of coercive procedure, which takes less time than the executive procedure. In all cases, the enforcement of the judgment will depend on if it is enforceable, and, if it is enforceable, the court will execute the judgment within the time established or, failing that, within three days.

7.4 With respect to enforcing collateral security, are there any significant restrictions which may impact the timing and value of enforcement, such as (a) a requirement for a public auction, or (b) regulatory consents?

It depends on the guarantee. In general, a public auction is required. This involves a procedure that might take over a month. However, no regulatory consents are needed to enforce collateral securities.

7.5 Do restrictions apply to foreign lenders in the event of (a) filing suit against a company in your jurisdiction, or (b) foreclosure on collateral security?

No. If the requirements are met, there is no restriction on the lender to filing a law suit against the borrower or the guarantee it has granted.

7.6 Do the bankruptcy, reorganisation or similar laws in your jurisdiction provide for any kind of moratorium on enforcement of lender claims? If so, does the moratorium apply to the enforcement of collateral security?

Please see the answer to question 8.1.

7.7 Will the courts in your jurisdiction recognise and enforce an arbitral award given against the company without re-examination of the merits?

Bolivia has signed and ratified the New York Convention on the enforcement of arbitral awards. In this sense, the Bolivian courts do recognise such decisions without needing to re-examine their merits. Moreover, the new civil procedure code prescribes that arbitral awards enable a lender to initiate a coercive enforcement of a debt, and it is not necessary for the judge to re-examine the merits of such arbitral award.

The procedure to enforce a foreign arbitral award is the same as described in question 7.2 for foreign judgments.

8 Bankruptcy Proceedings

8.1 How does a bankruptcy proceeding in respect of a company affect the ability of a lender to enforce its rights as a secured party over the collateral security?

The ability of a lender is affected because the entire bankruptcy process is handled by a judge. In this sense, the affected lender cannot seek the enforcement of its security as freely as in the case of not being subject to the debtor company's bankruptcy. However, bankruptcy does not involve any other violation of the right of the lender to make a debt enforceable and the debt shall be paid by means of the security given by the debtor.

8.2 Are there any preference periods, clawback rights or other preferential creditors' rights (e.g., tax debts, employees' claims) with respect to the security?

All guarantees have priorities on the enforcement of the goods or assets given as such. However, tax debts and employee claims are always taken as preferential creditors' rights in the case of bankruptcy of the borrower.

8.3 Are there any entities that are excluded from bankruptcy proceedings and, if so, what is the applicable legislation?

Yes; financial intermediaries, for example, are only subject to a process of "intervention", after which it is to be decided whether to give it a solution or to proceed to compulsory liquidation.

8.4 Are there any processes other than court proceedings that are available to a creditor to seize the assets of a company in an enforcement?

The only way other than court proceedings to seize the assets of a company in enforcement is a process called "*dación en pago*", which consists of a new transaction between the creditor and the debtor through which the creditor receives a new asset, or the asset given as a guarantee, as payment of his credit.

9 Jurisdiction and Waiver of Immunity

9.1 Is a party's submission to a foreign jurisdiction legally binding and enforceable under the laws of your jurisdiction?

Please see the answer to question 7.1. However, a party cannot submit to a foreign jurisdiction on its own, for it takes both parties to choose the jurisdiction that will rule the contract and its enforcement.

9.2 Is a party's waiver of sovereign immunity legally binding and enforceable under the laws of your jurisdiction?

If sovereign immunity was awarded to a party in Bolivia, it would be by means of a law; therefore it would not be a disposable right, which implies that a party's waiver of sovereign immunity would not be legally binding and enforceable under the laws of Bolivia. Nevertheless, in the event a party's sovereign immunity was awarded in a country the laws of which allow the waiver of sovereign immunity, then it would be legally binding and enforceable in Bolivia.

10 Licensing

10.1 What are the licensing and other eligibility requirements in your jurisdiction for lenders to a company in your jurisdiction, if any? Are these licensing and eligibility requirements different for a "foreign" lender (i.e. a lender that is not located in your jurisdiction)? In connection with any such requirements, is a distinction made under the laws of your jurisdiction between a lender that is a bank *versus* a lender that is a non-bank? If there are such requirements in your jurisdiction, what are the consequences for a lender that has not satisfied such requirements but has nonetheless made a loan to a company in your jurisdiction? What are the licensing and other eligibility requirements in your jurisdiction for an agent under a syndicated facility for lenders to a company in your jurisdiction?

Bolivian law provides that a bank or financial institution must be of domestic or foreign origin, and dedicated to perform financial intermediation and financial services to the public, both in the country and outside the country.

The financial intermediation and auxiliary financial services will be carried out by financial institutions authorised by the Supervisory Authority of the Financial System (ASFI). No person, natural or legal, will perform regularly in the territory of Bolivia the activities of financial intermediaries and financial auxiliaries services described by law, without prior permission of incorporation and operation granted by ASFI, with the formalities established by law.

Any natural or legal person, domestic or foreign, domiciled in the country or not, who does not meet the requirements and formalities concerning the organisation and functioning of financial intermediaries and financial auxiliaries services under the Act is prohibited from making announcements, publications and circulating papers, written or printed, the terms of which imply that such person has legal authorisation to perform activities reserved by law to the said banks. In the same way, any natural or legal person may not use in its name, in Spanish or another language, terms that may lead the public to be confused with legally authorised financial institutions.

The requirements for the establishment of a financial institution in Bolivia and for obtaining the operating licence are as follows:

(a) Founders may not:
   1. Be declared legally incapable to engage in commerce.
   2. Have an indictment or conviction for committing crimes.
   3. Have outstanding debts related to the financial system or running off loans.

(b) In order to obtain an operating licence, a financial institution must:
   1. Have conducted a study of economic and financial feasibility.
   2. Have drafted articles of incorporation and bylaws of a corporation.
   3. Have a certified personal history for individuals – issued by competent authority.
   4. Have a certificate of fiscal solvency and disclosure of assets of the founders.

Additionally, in August 2015, ASFI issued a regulation establishing the criteria to determine if a loan, a financial intermediation activity or any activity reserved for financial institutions exclusively, is made in a "massive" or in a "regular" way. Those criteria are based on the frequency of the activities aforementioned (weekly, monthly, quarterly, semi-annually and annually) and/or on the gross incomes earned monthly, quarterly, semi-annually and annually by the lender. According to this regulation, if a natural or legal person acts as a lender or as a financial intermediary meeting the criteria set out in the regulation, such activity is considered illegal and has the following consequences: a) ASFI will issue a stopping order for the person performing the illegal activity; b) if an unauthorised lender has any office in Bolivia, ASFI will be able to close it permanently; and finally c) unauthorised financial intermediation activities can be prosecuted as crimes before Bolivian courts. This regulation remains in force today.

11 Other Matters

11.1 Are there any other material considerations which should be taken into account by lenders when participating in financings in your jurisdiction?

The considerations that should be taken into account are those that are provided by law and detailed in this chapter.

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Andrea Mariah Urcullo Pereira graduated as a lawyer from Universidad Católica Boliviana San Pablo in La Paz in 2010. She holds a Master's degree in Banking and Finance in *Centro de Estudios Garrigues*, in Madrid – Spain. She also holds a History Master's degree. She is currently in an internship programme at the National Commission of the Securities Market ("*Comisión Nacional del Mercado de Valores*") in Madrid – Spain. She joined Criales & Urcullo in 2012 as an associate lawyer. Her main practice areas are corporate and commercial law, financial law, compliance and regulation for the financial sector and intellectual property.

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Daniel Mariaca Alvarez was born in La Paz in 1980. He graduated from Universidad Católica Boliviana on 2005.

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Daniel joined Criales & Urcullo in 2006 and worked there until 2012 when he went to work for YPFB Andina S.A., the biggest oil and gas company in Bolivia. In 2013, he was hired by Sinchi Wayra S.A., one of the biggest mining companies in the country. Finally, in 2015, he rejoined Criales & Urcullo as an associate lawyer.

In 2017, Daniel was made partner of the firm.

His practice focuses on Corporate Law.

Criales & Urcullo
ABOGADOS

Criales & Urcullo is a full-service law firm serving the needs of businesses, governmental entities, non-profit organisations and individual clients in Bolivia and other Latin American countries. At Criales & Urcullo we measure our success by the success of our clients and the longevity of their relationships with us.

Our law firm is the most significant legal services provider to the securities market in Bolivia. Our clients in this sector are the Bolivian Stock Exchange, the Bolivian Central Depository, and the country's biggest stock exchange brokers and investment funds.

Botswana

Wandipa T. Kelobang

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1 Overview

1.1 What are the main trends/significant developments in the lending markets in your jurisdiction?

The market is moving away from the traditional methods of raising capital which has been predominantly through bank loans. As banks are imposing more requirements to provide funds, companies find themselves having to explore other avenues of raising capital such as bond issuances and debentures.

1.2 What are some significant lending transactions that have taken place in your jurisdiction in recent years?

Most transactions we would not be aware of as they are not publicly available information. However, transactions made public include bonds, as the information is publicly available, and include:

- Botswana Housing Corporation BWP300,000,000 floating rate note due December 10, 2025 under its BWP2,000,000,000 domestic note programme; and
- Getbucks Botswana BWP5,000,000 fixed rate note due March 23, 2019 under its BWP500,000,000 domestic medium note programme.

2 Guarantees

2.1 Can a company guarantee borrowings of one or more other members of its corporate group (see below for questions relating to fraudulent transfer/financial assistance)?

Yes, a company can guarantee borrowings in Botswana.

2.2 Are there enforceability or other concerns (such as director liability) if only a disproportionately small (or no) benefit to the guaranteeing/securing company can be shown?

Enforceability issues may arise looking at the nature of the transaction. Section 128 of the Companies Act [Cap 42:01] (the Act) requires some major transactions to be approved by special resolution, which means a resolution approved by 75% of those entitled to vote. Therefore, if the guarantee makes the company incur obligations or liabilities, the value of which is more than half the value of the company's assets before the transaction, then it requires approval by special resolution. However, a lender is not required to inquire whether the above has been satisfied and no debt incurred or contract entered into shall be invalid or ineffectual except in the case where actual notice was given, at the time the agreement was being entered into, that the company was acting in breach of Section 128 of the Companies Act.

Further, directors of a company are required to always act in good faith and in the best interest of the company [Section 130 of the Act]. In executing their duties, directors are to exercise a degree of care, diligence and skill honestly, in good faith and in the best interest of the company. A director who breaches the above may be liable to compensate the company for any loss suffered as a result of the breach among other remedies under Section 158(3) of the Companies Act.

2.3 Is lack of corporate power an issue?

As already stated above, Section 128(4) of the Act states that lack of corporate power is not an issue to a lender, unless actual notice was given at the time the agreement was being entered into that the company was acting in breach of Section 128 of the Companies Act.

Further, Section 28 of the Companies Act abolishes the doctrine of constructive notice. Hence, no person is expected to have notice or knowledge of the contents of the company's constitution or any other document by virtue of the fact that it was registered by the Registrar or is available for inspection at the office of the company. Therefore, a person dealing with a company is entitled to assume in the absence of facts putting him on inquiry that there has been due compliance with all matters of internal management and procedure as required.

2.4 Are any governmental or other consents or filings, or other formalities (such as shareholder approval), required?

The Companies Act, under Section 128, requires a special resolution; i.e. 75% of the shareholders' vote.

2.5 Are net worth, solvency or similar limitations imposed on the amount of a guarantee?

Section 130 (1) (e) of the Companies Act provides as one of the duties of directors not to agree to the company incurring any obligation unless the director believes that the company will be able to perform such obligation.

2.6 Are there any exchange control or similar obstacles to enforcement of a guarantee?

Botswana does not have exchange controls.

3 Collateral Security

3.1 What types of collateral are available to secure lending obligations?

Collateral can be any asset, be it movable, immovable or other receivables. The most used types of collateral are as follows:

a) a mortgage bond which is passed over immovables;

b) a deed of hypothecation which is passed over tangible and intangible movables;

c) a cession which is passed over intangible property or a right;

d) a general notarial bond which is passed over tangible movable property; and

e) a pledge which is granted with respect of tangible movables and requires possession or delivery for it to be perfected.

3.2 Is it possible to give asset security by means of a general security agreement or is an agreement required in relation to each type of asset? Briefly, what is the procedure?

Different types of securities are given differently for different assets. For immovable property, a mortgage bond must be prepared by a conveyancer and registered with the Registrar of Deeds. For tangible and intangible movables, a deed of hypothecation must be prepared by a conveyancer and registered with the Registrar of Deeds. It must be noted that a deed of hypothecation can be registered in favour of an authorised creditor under the Hypothecation Act [Cap 46:05]. A cession granting security over intangible movable property is created by the cedent in favour of the cessionary. It does not require registration. It can be structured as either a cessionary in *securitatem debiti* where title to the property remains with the cedent or an *out and out* cession where title to the property is transferred to the cessionary, subject to the cedent's rights to have the property transferred back once the debt has been discharged. A general notarial bond is required to be registered at the Deeds Registry and must be prepared by a notary public. In a pledge, delivery must be demonstrated to any third party that may have a competing interest.

3.3 Can collateral security be taken over real property (land), plant, machinery and equipment? Briefly, what is the procedure?

Yes, security can be taken over such as stated under question 3.2 above.

3.4 Can collateral security be taken over receivables? Briefly, what is the procedure? Are debtors required to be notified of the security?

Receivables are normally pledged as security. Usually, when accounts receivables are used as collateral, the lender typically limits the amount of the loan to a percentage of the total amount of accounts receivables, or a percentage of the total amount based on the age of receivables. For example, a lender may not permit a company to use accounts receivables that are past their due date. If a lender chooses to allow a company to use accounts receivables as an asset for collateral, the company is still responsible for collecting the outstanding receivables. Companies are not required to notify customers of any pledging arrangement.

3.5 Can collateral security be taken over cash deposited in bank accounts? Briefly, what is the procedure?

The most common form of security over cash deposits is usually created by a cession in security of the borrower's bank accounts.

3.6 Can collateral security be taken over shares in companies incorporated in your jurisdiction? Are the shares in certificated form? Can such security validly be granted under a New York or English law-governed document? Briefly, what is the procedure?

Yes, shares can be given as security. The most common way of taking security over shares is through a pledge and, in respect of private companies, the pre-emptive right of other shareholders must be taken into account and if possible, it must be waived. Delivery is effected by submission of the original share certificates, reflecting the pledge on the share register and delivery of share transfer forms signed by the transferor and left blank for the transferee. A pledge does not need to be registered and needs a court order for enforcement. Security can be granted under New York and English law-governed documents. However, it is advisable to obtain an opinion on enforceability.

3.7 Can security be taken over inventory? Briefly, what is the procedure?

Yes, it can and will have similar considerations as those stated at question 3.4 above.

3.8 Can a company grant a security interest in order to secure its obligations (i) as a borrower under a credit facility, and (ii) as a guarantor of the obligations of other borrowers and/or guarantors of obligations under a credit facility (see below for questions relating to the giving of guarantees and financial assistance)?

Yes, a company can grant a security interest to secure its obligations both as a borrower or as a guarantor.

3.9 What are the notarisation, registration, stamp duty and other fees (whether related to property value or otherwise) in relation to security over different types of assets?

For the above-stated securities which are required to be prepared by a conveyancer or notary public and are required to be lodged at the Deeds Registry, the fees payable to a conveyancer or notary are those related to the value of the transaction as prescribed by the tariff. However, there are no other fees payable for registration.

3.10 Do the filing, notification or registration requirements in relation to security over different types of assets involve a significant amount of time or expense?

There are no prescribed timelines for security registration at the Deeds Registry. However, registration of securities at the Deeds Registry is quite efficient and the time lines are normally commercially acceptable. A transaction can be expedited if the parties can demonstrate to the Registrar of Deeds that there are reasons to treat it as urgent. The expenses for registered security are prescribed as mentioned in question 3.9 above.

3.11 Are any regulatory or similar consents required with respect to the creation of security?

For any creditor to take a deed of hypothecation, they must be an authorised creditor under the Hypothecation Act. Further, for the bonds there is a need to show authority to borrow and give security, to lend and take security as well as a resolution of the board of directors resolving to pass the bond and authorising the signatories to sign on behalf of the borrower.

3.12 If the borrowings to be secured are under a revolving credit facility, are there any special priority or other concerns?

There are no special priority or other concerns for a security given for a revolving credit facility.

3.13 Are there particular documentary or execution requirements (notarisation, execution under power of attorney, counterparts, deeds)?

For all the securities that need to be filed at the Deeds Registry, the following are needed: a power of attorney; a resolution if the security is passed by a company; a deed executed by a conveyancer; the original title of the immovable property (for a mortgage bond); as well as the identity documents of signatories representing the borrower.

4 Financial Assistance

4.1 Are there prohibitions or restrictions on the ability of a company to guarantee and/or give security to support borrowings incurred to finance or refinance the direct or indirect acquisition of: (a) shares of the company; (b) shares of any company which directly or indirectly owns shares in the company; or (c) shares in a sister subsidiary?

A company is prohibited from giving financial assistance directly or indirectly to any person for the purpose of or in connection with the acquisition of its own shares, except as provided for under Section 76(1) of the Act. A company may give financial assistance for the acquisition of its shares if: the board has resolved that it is in the best interest of the company; the terms and conditions of the assistance are fair and reasonable to the company and shareholders not receiving the assistance; and immediately after giving the assistance the company will satisfy the solvency test (see Section 76(2)). Where the amount of any financial assistance approved by the company, together with the amount of any other financial assistance given by the company which is still outstanding, exceeds 10% of the company's stated capital, the company cannot give the assistance unless it first obtains from its auditors a certificate that they have inquired into the state of affairs of the company and they are not aware of anything to indicate that the opinion of the board on the terms and conditions on which the assistance is given is unreasonable in the circumstances.

However, Section 77 sets out transactions that are not prohibited by Section 76, which are: an approved distribution to shareholders; the issue of shares; a repurchase or redemption of the company's shares; anything done under a compromise or arrangement under the Act; where the ordinary business of the company includes the lending of money by the company; the provision in good faith in the interests of the company of financial assistance for the purposes of an employee share scheme; and making of loans in good faith to the employees including executive directors but not including non-executive directors with a view to enable them to acquire beneficial ownership of shares in the company (see Section 71(a) – (g)).

As a way of strengthening the rule against corporate share repurchases, a company cannot be a member of a company which is its holding company and any allotment or transfer of shares in a company is void as provided for under Section 78 (1) – (3). However, the section does not apply where the subsidiary is a member of its holding company as personal representative or as trustee, unless the holding company or its subsidiary is beneficially interested under the trust and is not interested only by way of security for the purposes of transactions entered by it in the ordinary course of business which include the lending of money (see Section 78(4)).

5 Syndicated Lending/Agency/Trustee/Transfers

5.1 Will your jurisdiction recognise the role of an agent or trustee and allow the agent or trustee (rather than each lender acting separately) to enforce the loan documentation and collateral security and to apply the proceeds from the collateral to the claims of all the lenders?

An agent or trustee arrangement is recognised in Botswana. Lenders in syndicated loan or funding structures can appoint one of the finance parties or a third party to perform the role of trustee or agent, which is purely an administrative role. The agent or trustee can enforce rights on behalf of the lenders, provided that the relevant loan and security documents stipulate that.

5.2 If an agent or trustee is not recognised in your jurisdiction, is an alternative mechanism available to achieve the effect referred to above which would allow one party to enforce claims on behalf of all the lenders so that individual lenders do not need to enforce their security separately?

This is not applicable in Botswana.

5.3 Assume a loan is made to a company organised under the laws of your jurisdiction and guaranteed by a guarantor organised under the laws of your jurisdiction. If such loan is transferred by Lender A to Lender B, are there any special requirements necessary to make the loan and guarantee enforceable by Lender B?

There is no legislation governing this. As a loan is an agreement between a lender and a borrower, there is a need for the agreement to allow for the lender to assign his rights to another entity. In some instances, the loan agreement will provide that the borrower must give consent.

6 Withholding, Stamp and Other Taxes; Notarial and Other Costs

6.1 Are there any requirements to deduct or withhold tax from (a) interest payable on loans made to domestic or foreign lenders, or (b) the proceeds of a claim under a guarantee or the proceeds of enforcing security?

In terms of the Income Tax Act, interest payable to or for the benefit of both domestic and foreign lenders is subject to withholding tax at the rate of 15%, provided that such interest is accrued from a source situated in Botswana. The Act is silent with regards to withholding tax from the proceeds of a claim under a guarantee or the proceeds of enforcing security.

6.2 What tax incentives or other incentives are provided preferentially to foreign lenders? What taxes apply to foreign lenders with respect to their loans, mortgages or other security documents, either for the purposes of effectiveness or registration?

There are no preferential tax incentives for foreign lenders for lending in Botswana.

6.3 Will any income of a foreign lender become taxable in your jurisdiction solely because of a loan to, or guarantee and/or grant of, security from a company in your jurisdiction?

No. The foreigner will be subject to tax on income that is deemed to have its source in Botswana.

6.4 Will there be any other significant costs which would be incurred by foreign lenders in the grant of such loan/guarantee/security, such as notarial fees, etc.?

There is no stamp duty or any other significant costs payable by foreign lenders in the grant of loans/guarantee/security except for the fees payable to the conveyancer or notary as already stated at question 3.9 above.

6.5 Are there any adverse consequences for a company that is a borrower (such as under thin capitalisation principles) if some or all of the lenders are organised under the laws of a jurisdiction other than your own? Please disregard withholding tax concerns for purposes of this question.

In terms of the Income Act, thin capitalisation rules are only in relation to mining companies and International Financial Services Centre (IFSC) companies.

Where a foreign lender grants a loan to a Botswana resident mining company, the deduction of interest is restricted to a 3:1 debt-to-equity ratio. Any interest charged in excess of the 3:1 ratio will be disallowed as a deduction from income of the Botswana mining company. The disallowable interest will constitute a deemed dividend for withholding tax purposes, and the rate of 15% will be payable on the quantum of the adjustment passed.

7 Judicial Enforcement

7.1 Will the courts in your jurisdiction recognise a governing law in a contract that is the law of another jurisdiction (a "foreign governing law")? Will courts in your jurisdiction enforce a contract that has a foreign governing law?

The Botswana courts recognise foreign law and would enforce such law. It is settled law that foreign law is a question of fact and must be pleaded and proved. The burden of proving foreign law lies on the party who bases its claim on it.

7.2 Will the courts in your jurisdiction recognise and enforce a judgment given against a company in New York courts or English courts (a "foreign judgment") without re-examination of the merits of the case?

Where one party is successful in proceedings in a foreign court, he may apply to a Botswana court to have the foreign judgment recognised so as to avoid starting fresh proceedings on the same matter or re-examination of the merits of the case. The successful party may also apply to obtain the relief awarded by the foreign court. There are conditions to be satisfied before a foreign judgment can be recognised and enforced under Botswana law. These are:

a) that the foreign court/adjudicating court should have had the jurisdiction to hear the matter;

b) reciprocal treatment would be given to a Botswana judgment in that country;

c) that the judgment rendered was final and conclusive; and

d) the recognition and enforcement of the judgment must not be against public policy.

7.3 Assuming a company is in payment default under a loan agreement or a guarantee agreement and has no legal defence to payment, approximately how long would it take for a foreign lender to (a) assuming the answer to question 7.1 is yes, file a suit against the company in a court in your jurisdiction, obtain a judgment, and enforce the judgment against the assets of the company, and (b) assuming the answer to question 7.2 is yes, enforce a foreign judgment in a court in your jurisdiction against the assets of the company?

There is no prescribed time-frame as to how long it would take for a foreign lender to file a suit against the company in default of a loan agreement, obtain a judgment and enforce the judgment against the assets of company. However, once default has occurred, the foreign lender can institute an action. If undefended, it may apply for judgment in default of appearance by the company. If defended, it may apply for a summary judgment based on the loan agreement and meeting the requirements. If the company still does not pay despite the judgment being entered against it, the foreign lender may seek for attachment of the company assets to recover the amount due to it.

A judgment creditor under the foreign judgment may apply to the High Court at any time within six years of the date of the last judgment given in the matter to have the judgment registered in the High Court. If the applicant or judgment debtor satisfies the requirement of recognition and enforcement of a foreign judgment as discussed in question 7.2 above and a Botswana court grants an order recognising it, the foreign lender can enforce the judgment as if the said judgment was granted by a court of Botswana.

7.4 With respect to enforcing collateral security, are there any significant restrictions which may impact the timing and value of enforcement, such as (a) a requirement for a public auction, or (b) regulatory consents?

A lender will need a court order before enforcing security. Therefore, going to court to obtain the order may impact timing. Any sale in execution ordered by the court must be conducted by public auction. We are not aware of any regulatory consents required for the enforcement of a security.

7.5 Do restrictions apply to foreign lenders in the event of (a) filing suit against a company in your jurisdiction, or (b) foreclosure on collateral security?

No. Foreign and domestic lenders are treated the same in terms of any applicable restrictions.

7.6 Do the bankruptcy, reorganisation or similar laws in your jurisdiction provide for any kind of moratorium on enforcement of lender claims? If so, does the moratorium apply to the enforcement of collateral security?

Yes. During liquidation of a company, the estate of the insolvent is frozen and all proceedings against the insolvent company are suspended until a liquidator is appointed. A secured creditor is not allowed to enforce its rights under the security agreement but must deliver any secured property held by it to the liquidator of the insolvent company for realisation.

7.7 Will the courts in your jurisdiction recognise and enforce an arbitral award given against the company without re-examination of the merits?

The Botswana Recognition of Foreign Arbitral Awards Act [Cap 06:02], giving effect to the Convention on Recognition and Enforcement of Foreign Arbitral Awards, prescribes that an Arbitral Award made in any country which is party to the Convention shall be binding and may be enforced in Botswana as if it were enforced under the provisions of the Botswana Arbitration Act.

8 Bankruptcy Proceedings

8.1 How does a bankruptcy proceeding in respect of a company affect the ability of a lender to enforce its rights as a secured party over the collateral security?

The secured lender cannot attach or enforce its rights over the collateral security once winding up or judicial management proceedings have commenced. The lender must, however, deliver such security held by it to the appointed liquidator of the insolvent estate for realisation.

Any cash or proceeds realised through the disposal of the secured assets, after the deduction of liquidation costs, will be paid to creditors. Secured creditors in the insolvent estate are paid out before any other creditor.

8.2 Are there any preference periods, clawback rights or other preferential creditors' rights (e.g., tax debts, employees' claims) with respect to the security?

Once the secured creditors in the insolvent estate are paid out, preferential creditors are paid. Then, salaries or wages or any outstanding amounts due to employees are paid, and finally tax debts are to be paid.

8.3 Are there any entities that are excluded from bankruptcy proceedings and, if so, what is the applicable legislation?

None that we are aware of.

8.4 Are there any processes other than court proceedings that are available to a creditor to seize the assets of a company in an enforcement?

Botswana law does not recognise self-help and para execute clauses in credit agreements when dealing with the enforcement of security. All securities must be enforced through the courts where a proper order of attachment will be sought.

9 Jurisdiction and Waiver of Immunity

9.1 Is a party's submission to a foreign jurisdiction legally binding and enforceable under the laws of your jurisdiction?

A party's submission to a foreign jurisdiction is legally binding and enforceable under Botswana law.

9.2 Is a party's waiver of sovereign immunity legally binding and enforceable under the laws of your jurisdiction?

A party's waiver of sovereign immunity is legally binding and enforceable under the laws of Botswana. A party is deemed to have waived its immunity if it institutes proceedings in Botswana courts, or if it has intervened or taken any steps in the proceedings at court, save for pleading immunity. It may also arise from an appeal of a decision and to any counterclaim arising out of the same legal claim.

10 Licensing

10.1 What are the licensing and other eligibility requirements in your jurisdiction for lenders to a company in your jurisdiction, if any? Are these licensing and eligibility requirements different for a "foreign" lender (i.e. a lender that is not located in your jurisdiction)? In connection with any such requirements, is a distinction made under the laws of your jurisdiction between a lender that is a bank *versus* a lender that is a non-bank? If there are such requirements in your jurisdiction, what are the consequences for a lender that has not satisfied such requirements but has nonetheless made a loan to a company in your jurisdiction? What are the licensing and other eligibility requirements in your jurisdiction for an agent under a syndicated facility for lenders to a company in your jurisdiction?

The licensing and regulatory framework of the financial services sector has two distinct categories, governed respectively in accordance with the Banking Act and the Non-Bank Financial Institutions Regulatory Authority Act.

The Bank of Botswana is responsible for bank regulation and supervision in Botswana. In terms of the Banking Act, no person shall transact banking business in Botswana without a valid licence issued by the Bank of Botswana. The Act widely describes the banking business as one of accepting deposits of money repayable on demand or after fixed periods of time, the employment of deposits in making or giving loans, advances, overdrafts and in the making of investments. No applicant shall be granted a licence unless it is incorporated under the Companies Act and limited by share capital, and the Bank of Botswana is satisfied that it is a fit and proper recipient of a banking licence.

The licensing and eligibility requirements may be different for a foreign lender. According to the Banking Act, a foreign bank means an institution incorporated in a country other than Botswana, and subject to a foreign jurisdiction, which is licensed to do banking business according to the laws of that country.

However, no foreign bank shall, without the written authority of the Central Bank, establish a representative office in Botswana. Like local banks, no representative office shall conduct any banking business in Botswana without a valid licence issued by the Bank of Botswana.

The Non-Bank Financial Institutions Authority ("NBFIRA") is responsible for regulating and supervising Non-Bank Financial Institutions in Botswana. In terms of the Non-Bank Financial Institutions Regulatory Act ("NBFIRA Act"), a non-financial institution means, *inter alia*, an asset manager, an administrator of a pension/provident fund, a person operating a central security depository, a collective investment undertaking, a micro-lender, a financial group, a member of the insurance industry, an insurance broker, a financial or leasing company, etc. NBFIRA may, upon application, grant a licence to an establishment as a non-bank financial institution of a kind specified in the licence. NBFIRA shall not grant the licence unless it is satisfied that the applicant will carry on the activities to be covered by the licence with integrity, prudence and professional skill, will maintain a sound financial position and not cause or promote instability in the financial system and the applicant otherwise meets and will continue to meet the requirements of the financial services law.

For lenders who have not obtained the valid necessary licence but still make loans to companies in Botswana, both the Banking Act and the NBFIRA Act have penalty provisions which deal with unlicensed banking and penalties for breaches of financial services laws. In terms of the Banking Act, where upon an investigation, the Bank of Botswana determines that banking business is transacted without a valid licence, it may order that such activities be suspended forthwith. Any person who contravenes any order of suspension shall be guilty of an offence and liable to a fine of BWP2,000 for each day on which the contravention occurs. The Bank of Botswana shall make an application to the High Court for directions in respect of the disposition of all monies, securities and other assets in the possession of an unlicensed person and obtained by him whilst transacting banking business without a valid licence.

In terms of the NBFIRA Act, a person who carries on a business as a non-bank financial institution without a licence commits an offence and on conviction is liable to a fine not exceeding BWP2,500 for each day on which the offence occurs or continues to occur or to imprisonment for a period not exceeding five years, or to both. In terms of the act, carrying on a business as a non-bank financial institution includes carrying on such a business by providing financial services.

There are no eligibility requirements for an agent under a syndicated facility for lenders to a company in Botswana.

11 Other Matters

11.1 Are there any other material considerations which should be taken into account by lenders when participating in financings in your jurisdiction?

Botswana undoubtedly has the most competitive and progressive banking systems in the region. Entrepreneurs generally have good access to credit. It is to be significantly noted that no person may advertise or provide financial services including offering bank deposits, selling insurance products, or being involved in a micro-lending business or any interest bearing business activity without obtaining a licence from either the Bank of Botswana or NBFIRA.

The government is also involved in finance through its financial institutions and incentives. One notable government financial regulatory agency is the International Financial Services Centre ("IFSC"), which aims to develop Botswana into a hub for cross-border financial and business services in the region. The government encourages foreign lenders wishing to set up banks, insurance companies and fund management companies to use the IFSC.

Furthermore, the Botswana Stock Exchange has enjoyed impressive rates of growth throughout the years to date. The exchange is also involved in the development of more instruments which are more than traditional shares (equities) to be listed in the exchange, to give investors a variety of exchange-listed instruments.

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Kelobang Godisang Attorneys is a boutique firm specialising in providing high-quality legal advice in the field of commercial law. We have a young and highly motivated team of lawyers with unrivalled experience in their areas of practice. We pride ourselves in bringing efficiency, risk management, world-class experience and assisting our clients to view their operations from different perspectives, hence our tag line “For a 360° perspective”. Our firm has advised on some of the notable transactions in the jurisdiction.

Chapter 37

Brazil

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1 Overview

1.1 What are the main trends/significant developments in the lending markets in your jurisdiction?

Brazil has a highly sophisticated financial system, with a set of detailed and specific rules and regulations that must be observed, on the one hand, by local lenders (banks and financial institutions) and creditors (investment funds, securitisation vehicles and market investors) and, on the other hand, by borrowers and/or issuers of debt instruments (in terms of disclosure rules, registration requirements, exposure regarding specific lenders, collateral creation requirements, among others).

Given a stable and promising economic scenario in the early 2000s, the level of debt incurred by local companies over the past 10 years doubled. Such growth in debt transactions was also verified due to the creation by the local government of a set of rules which provided better security to creditors such as: the creation of types of collateral with a more expeditious foreclosure proceedings (fiduciary sale/assignment of immovable and movable assets); better clarification on the rules governing extrajudicial and in-court debt reorganisations; the creation of new debt instruments better evidencing credit transactions (such as banking credit notes – *cédulas de crédito bancário* – and banking financial notes – *letras financeiras*); and the enactment of incentives for the use of the local capital markets for the private funding of local companies (through the issuance of debentures, for instance).

During such period, an increase of lending/credit transactions was verified in a number of local market segments, including: typical commercial lending transactions, the proceeds of which being used for the short/medium-term cash needs of local companies; foreign currency denominated bond offerings, implemented by companies whose revenues are indexed to foreign currency (such as agribusiness and the oil & gas sector, as well as large exporters); and syndicated loan transactions (local and international lenders), in which short-term debt of local companies was converted into long-term ones with better conditions.

Given the shortage of infrastructure in Brazil, the local government is promoting a number of public bids to try to bring local and foreign private investors to manage a number of infrastructure sectors, including energy generation and transmission, renewable energy projects, state and federal highways, ports, airports, logistics and urban mobility, among others. The funding needs of such long-term infrastructure projects is being provided not only by the local federal Exim bank (BNDES), but also by private banks (granting of bank guarantees and bridge loans) and the local capital markets (in this regard, a specific debt instrument was created by the government in 2011 – infrastructure debentures – which granted tax exemptions to local and foreign investors).

As from 2013, the crisis affecting emerging markets globally had a relevant impact on the Brazilian economy which was evidenced in a decrease in lending transactions and a rise in interest rates, promoting a scenario in which lenders became more selective and companies began to try to renegotiate previous transactions (as opposed to entering into new debt).

Until December 2016, given the economic scenario, local lending markets were: implementing structures aimed at providing credit transactions with more attractive interest rates (such as capital markets transactions, with comprehensive collateral packages); renegotiating or exchanging lending transactions that will mature within a short-/medium-term period; and using mechanisms or implementing structured transactions that may have a lower impact in the debt obligations of local companies (such as securitisation transactions).

The Brazilian economy has been recovering since the latest political events and the local lending market is becoming even more attractive to foreign and local investors. Some Brazilian companies started looking offshore for lending opportunities, followed by several debt issuances by Petrobras throughout 2016 and 2017.

As an indication of the recent recovery of the Brazilian economy, it is worth mentioning the several equity and debt capital market transactions which occurred throughout 2017 (e.g., IPOs of Carrefour (Atacadão), Movida, Biotoscana and the follow-on of Azul and many other that are currently in the pipeline of investment banks to be launched in 2018).

1.2 What are some significant lending transactions that have taken place in your jurisdiction in recent years?

Recently, certain relevant lending transactions were completed in the local markets, such as: the issuance of US$ 6.75bn five- and 10-year dollar-denominated bonds by Petrobras (May 2016) and US$ 2bn (January 2018); the switch made by USJ of bonds in April, replacing US$ 246 million of its 9.875% 2019 bond with a US$ 197 million 9.875%/12% payment-in-kind toggle note due in 2021; the issuance by Marfrig Holdings (Europe) BV, a European subsidiary of Marfrig Global Foods S.A., of a seven-year single-tranche bond, raising US$ 750 million at a yield of 8.25%; the R$ 5bn issuance of Tier I perpetual bonds by Banco Itaú Unibanco; JSL Europe issuance of bonds in the amount of US$ 300 million; the US$ 1 billion issuance of notes by Cemig; US$ 400 million issuance of bonds by Azul; and US$ 1bn issuance of notes by BNDES.

In the infrastructure sector only, it is expected that over the next five years an amount of approximately R$ 70bn to R$ 100bn will be needed by local companies, given their long-term financial needs.

2 Guarantees

2.1 Can a company guarantee borrowings of one or more other members of its corporate group (see below for questions relating to fraudulent transfer/financial assistance)?

Yes. Pursuant to Brazilian laws and regulations, there is no limitation for a company to guarantee borrowings of one or more other members of its corporate group.

2.2 Are there enforceability or other concerns (such as director liability) if only a disproportionately small (or no) benefit to the guaranteeing/securing company can be shown?

There are no enforceability concerns if all the required corporate approvals (as required by the companies' by-laws or articles of association) are in place. Brazilian law defines personal guarantees, such as surety (*fiança)* as an accessory personal obligation which depends on a main obligation to which it is bound. If the main obligation ceases to exist, the *fiança* will not endure.

It is important to bear in mind, however, that such guarantees are usually granted without any consideration to be received by the guarantor and, in the event that a guarantor were to become insolvent or subject to a reorganisation proceeding (*recuperação judicial ou extrajudicial*) or to bankruptcy, the guarantees, if granted up to two years before the declaration of bankruptcy, may be deemed to have been fraudulent and declared void, based upon such guarantor being deemed not to have received fair consideration in exchange for its guarantee.

2.3 Is lack of corporate power an issue?

Yes. In order to execute a legal, valid and enforceable guarantee, the representative of the guarantor, executing the appropriate document, must have all corporate powers, pursuant to the company's by-laws or articles of association and power-of-attorney; otherwise the guarantee can be declared null and void.

2.4 Are any governmental or other consents or filings, or other formalities (such as shareholder approval), required?

Generally, depending on the amount of the guarantee, it will be necessary to obtain approval from a shareholders' or management's meeting of the company, pursuant to its by-laws or articles of association.

2.5 Are net worth, solvency or similar limitations imposed on the amount of a guarantee?

No. The amount of a guarantee can be established freely by the parties.

2.6 Are there any exchange control or similar obstacles to enforcement of a guarantee?

There are no specific exchange controls for the enforcement of a guarantee. Brazilian exchange controls are focused on remittances from and to outside Brazil, registering such remittances on the Brazilian Central Bank's system. Additionally, it is worth noting that remittances abroad can only be made by financial institutions.

3 Collateral Security

3.1 What types of collateral are available to secure lending obligations?

Under Brazilian law, collateral arrangements (*in rem* guarantees) are usually created by either a pledge (*penhor*), a fiduciary sale/assignment (*alienação/cessão fiduciária*) or a mortgage (*hipoteca*).

A pledge is an *in rem* guarantee and consists of the delivery of transferable movable property by a debtor (or by a third party on his behalf) to its creditor (or to the creditor's representative) in guarantee of the debt. It is important to note that a pledge generally requires *tradição*, i.e., the actual physical transfer of possession of the asset from the pledgor to the pledgee. A pledge creates a lien on movable property upon delivery thereof by the pledgor to the pledgee, with the express understanding that the asset shall be retained solely as security for a certain debt. Accordingly, the pledgee has the right to retain possession over the pledged asset, but it is not allowed to create any other type of interest over it. The pledge does not transfer title over the assets to the pledgee.

The fiduciary sale/assignment is a type of security interest, pursuant to which the debtor assigns to the creditor the title to ("*resolutory property*") and the "*indirect possession*" of a certain asset, holding, therefore, only its physical possession (or "*direct possession*"). The debtor has direct possession of the property and is liable for the duties of a bailee, or a trust, in relation to it. The debtor will have full title and indirect possession of the asset back when he has fulfilled all of its obligations under the guaranteed credit (that is why title of the creditor is called "*resolutory property*"). Such guarantee mechanisms have the effect of transferring to the creditor title to certain fungible movable assets (fiduciary sale) or to certain fungible rights over movable assets (fiduciary assignment), as the case may be.

Mortgage is an *in rem* guarantee lying over real estate granted by a debtor (or by a third party on its behalf) in favour of its creditor to secure payment of a relevant debt.

3.2 Is it possible to give asset security by means of a general security agreement or is an agreement required in relation to each type of asset? Briefly, what is the procedure?

Pledge and *alienação/cessão fiduciária* agreements and deeds of mortgages are formal documents which must comply with certain requirements for purposes of the perfection of the security interest created thereby, having specific formalities for each type. In this sense, the relevant security documents must, generally: (i) be in writing; (ii) be executed by both creditor and debtor and attested by two witnesses; (iii) contain, at a minimum, information pertaining to the amount, maturity and interest rate (whenever applicable) of the underlying obligation, as well as a description (including particulars) of the collateral; and (iv) be registered with the appropriate Brazilian Public Registry of the domicile of the debtor (e.g., the Registry of Deeds and Documents in the case of common pledges and of *alienação/cessão fiduciária* and the Real Estate Registry in case of mortgages or *alienação fiduciária* of real estate properties). Registration is a mandatory requirement for the perfection of the security interest.

3.3 Can collateral security be taken over real property (land), plant, machinery and equipment? Briefly, what is the procedure?

Yes. Please refer to the answers to questions 3.1 and 3.2 above.

3.4 Can collateral security be taken over receivables? Briefly, what is the procedure? Are debtors required to be notified of the security?

Yes, it is possible to take a collateral security over receivables, pursuant to Brazilian law. The collateral is usually formalised through a fiduciary assignment of the receivables, together with a fiduciary assignment over the accounts that will receive such receivables. As for the procedure, please refer to the answer to question 3.2 above.

3.5 Can collateral security be taken over cash deposited in bank accounts? Briefly, what is the procedure?

Yes, it is possible to take a collateral security over cash deposited in bank accounts, pursuant to Brazilian law. The collateral is usually formalised through a fiduciary assignment over the accounts. As for the procedure, please refer to the answer to question 3.2 above.

3.6 Can collateral security be taken over shares in companies incorporated in your jurisdiction? Are the shares in certificated form? Can such security validly be granted under a New York or English law governed document? Briefly, what is the procedure?

Yes, it is possible to take a collateral security over shares/quotas in companies incorporated in Brazil. The most common type of collateral over shares is *alienação fiduciária*. As the *alienação/cessão fiduciária* transfers the ownership of the shares to the creditor, the creditor, in general, will have priority in case of insolvency of the debtor, as provided by the Brazilian Bankruptcy Law. The creation of the security interest over shares is evidenced by formal documents which must comply with certain requirements for purposes of the perfection of the security interest created thereby. In this sense, the security documents must, generally: (i) be in writing; (ii) be executed by both creditor and debtor (as well as by the custodian, as the case may be) and attested by two witnesses; (iii) contain, at a minimum, information pertaining to the amount (either the exact, estimate or maximum amount), maturity and interest rate (whenever applicable) of the underlying obligation, as well as a description (including particulars) of the collateral; and (iv) be registered with the Registry of Deeds and Documents of the domicile of the debtor and creditor.

In addition to the registration before the Registry of Deeds and Documents, the security interest of registered shares is only created and perfected when the security interest is duly noted in the Share Registry Book. The security interest over shares held in custody with the stock exchange or other agent, in order to be valid in Brazil, must be duly registered in such system.

As regards quotas of limited liability companies, the most common type of collateral is pledge. Such collateral is usually registered through an amendment to the company's articles of association and filing of the respective quota pledge agreement before the Registry of Deeds and Documents.

In Brazil, shares are not usually issued in certificated form, despite the fact that the Brazilian Corporations Law allows such issuances. Shares are commonly issued as book entry records in the share registry book of the company issuer of the shares or registered with a bookkeeping entity.

Considering that the abovementioned types of collaterals are Brazilian types of collateral, the agreements creating such liens must be governed by Brazilian law; nevertheless, the main agreement, with terms and conditions of the credit being secured, can be governed by New York or English law.

Finally, it is worth mentioning that since January 2016 BM&FBOVESPA has been operating a new collateral system over shares of publicly held companies. Such new system enhanced the foreclosure procedures of collateral over shares of publicly held companies.

3.7 Can security be taken over inventory? Briefly, what is the procedure?

Yes, it is possible to take security over inventory. For the procedures involved, please refer to the answer to question 3.2 above.

3.8 Can a company grant a security interest in order to secure its obligations (i) as a borrower under a credit facility, and (ii) as a guarantor of the obligations of other borrowers and/or guarantors of obligations under a credit facility (see below for questions relating to the giving of guarantees and financial assistance)?

Yes, under Brazilian law, a company can grant a security interest in order to secure its obligations (i) as a borrower under a credit facility, and (ii) as a guarantor of the obligations of other borrowers and/or guarantors of obligations under a credit facility. It is worth mentioning that a thorough analysis of the company's by-laws or articles of association is required in order to assess, for each specific company, what are the required corporate approvals.

3.9 What are the notarisation, registration, stamp duty and other fees (whether related to property value or otherwise) in relation to security over different types of assets?

Usually, regardless of the type of assets being given as collateral, the registration fees (either for the Real Estate Registry or Registry of Deeds and Document) involve a percentage of the amount being secured by the collateral, limited to a cap. There are also notarisation fees; nevertheless, neither the notarisation nor the registration fees vary according to the region the competent registry is located.

3.10 Do the filing, notification or registration requirements in relation to security over different types of assets involve a significant amount of time or expense?

The period for registering security over different types of assets can vary from one to 30 days if there are no requirements made by the competent registry. Please note that registrations before the Real Estate Registry take longer than before the Registry of Deeds and Documents. It is also worth noting that registrations before registry offices located in smaller cities may take longer.

3.11 Are any regulatory or similar consents required with respect to the creation of security?

Generally, no regulatory or similar consent is required with respect to the creation of securities, except for companies that operate in regulated business such as energy, telecoms, etc., which may need authorisation from the regulatory agencies regulating such sectors.

3.12 If the borrowings to be secured are under a revolving credit facility, are there any special priority or other concerns?

No. The amount secured will always be the amount (or maximum amount) established on the respective agreement that formalises the collateral.

3.13 Are there particular documentary or execution requirements (notarisation, execution under power of attorney, counterparts, deeds)?

No particular documentary or execution requirements are needed, with the exception of mortgages which must be made through a public deed. It is also worth mentioning that if the agreements are in the English language, they must be translated into Portuguese before being registered. If the document is executed abroad, in order to be registered in Brazil, it must be notarised and legalised by the nearest Brazilian consulate of the place of execution. However, Brazil is about to adopt the apostille system in the next months.

4 Financial Assistance

4.1 Are there prohibitions or restrictions on the ability of a company to guarantee and/or give security to support borrowings incurred to finance or refinance the direct or indirect acquisition of: (a) shares of the company; (b) shares of any company which directly or indirectly owns shares in the company; or (c) shares in a sister subsidiary?

(a) Shares of the company

Until 2015, there was an overall restriction for publicly held companies becoming (by means of succession – i.e. merger) a debtor of financial obligations initially incurred by its controlling shareholder. Since June 2015, this restriction is no longer applicable.

(b) Shares of any company which directly or indirectly owns shares in the company

Generally, there are no restrictions for this hypothetical situation. However, please note the following: (i) it is not uncommon to find provisions in by-laws that prevent corporations from giving guarantees or security for the benefit of third parties; (ii) in case the so-called company (guarantor) is a Brazilian financial institution, insurance company or pension plan corporation, there could be a restriction depending on the amount of equity interest held by the beneficiary of the collateral/guarantee in the guarantor. Basically, such entities are not allowed to extend loans or give guarantees/ security for the benefit of certain persons (e.g. controlling shareholders and managers).

(c) Shares in a sister subsidiary

The same comments mentioned in item (b) above apply to this item. Also, generally, publicly held companies shall not offer collateral to secure obligations of a third party, especially if such third party is in any way related to the controlling shareholder of the said publicly held company.

5 Syndicated Lending/Agency/Trustee/ Transfers

5.1 Will your jurisdiction recognise the role of an agent or trustee and allow the agent or trustee (rather than each lender acting separately) to enforce the loan documentation and collateral security and to apply the proceeds from the collateral to the claims of all the lenders?

As lenders are not the direct beneficiaries of collateral agreements, should the lenders unilaterally file a lawsuit in Brazil to enforce the security interests created thereunder, it could be alleged that, by not being direct beneficiary under the collateral agreements, such party does not have legitimacy (*legitimidade*) to file a lawsuit and, if such allegation prevails, the lenders would not be able to enforce their security interest in courts on a unilateral basis; however, we understand that there are good arguments to sustain that the onshore collateral agent (trustee) has legitimacy (*legitimidade*) to represent the lenders, and any successor in lawsuits against the borrower and the guarantor, if the onshore collateral agent (trustee) is appointed as such by the lenders in the financing document governed by a foreign law.

5.2 If an agent or trustee is not recognised in your jurisdiction, is an alternative mechanism available to achieve the effect referred to above which would allow one party to enforce claims on behalf of all the lenders so that individual lenders do not need to enforce their security separately?

Please refer to the answer to question 5.1 above.

5.3 Assume a loan is made to a company organised under the laws of your jurisdiction and guaranteed by a guarantor organised under the laws of your jurisdiction. If such loan is transferred by Lender A to Lender B, are there any special requirements necessary to make the loan and guarantee enforceable by Lender B?

Unless there is an express prohibition in the loan agreement, credit assignments are valid under the laws of Brazil so long as the debtor is notified of the assignment. Generally, the collateral agreement is deemed as an ancillary obligation of the loan agreement (main obligation), which means that when the latter is assigned, the former is assigned too. From a practical perspective, it is advisable to amend both the loan agreement and respective collateral document with the names of the new debtor/guarantor to simplify the enforcement and avoid disputes on formal issues. Please note that, if a debt of a Brazilian company in relation to a foreign lender is assigned, in order to allow the remittance of funds to the new creditor, the registration of such debt before the Brazilian Central Bank must be updated.

6 Withholding, Stamp and Other Taxes; Notarial and Other Costs

6.1 Are there any requirements to deduct or withhold tax from (a) interest payable on loans made to domestic or foreign lenders, or (b) the proceeds of a claim under a guarantee or the proceeds of enforcing security?

(a) Interest payable by a Brazilian debtor to a foreign lender is generally subject to the withholding of income tax at a rate of 15% or 25% if the creditor is located in a blacklisted low-tax jurisdictions as defined in the applicable regulations. Interest payable by a Brazilian debtor to a local lender is also generally subject to the withholding of the income tax (not applicable to financial institutions) based on a regressive rates regime that vary from 22.5% to 15% according to the days elapsed since the loan was granted and the payment date. Note that, in this case, the tax withheld will be deemed a payment in advance of the corporate income tax locally due by the lender (at a general 34% rate for corporations and at a current 45% rate for financial institutions).

(b) The proceeds of a claim under a guarantee or enforcing security shall observe the same rules above, that is, the interest component paid by the lender would be subject to taxation, whereas principal should not be impacted by taxes. Other taxes may apply to either onshore and offshore loans transactions, although not under a withholding systematic.

6.2 What tax incentives or other incentives are provided preferentially to foreign lenders? What taxes apply to foreign lenders with respect to their loans, mortgages or other security documents, either for the purposes of effectiveness or registration?

One can highlight that cross-border loans whose proceeds are destined to the financing of Brazilian exports benefit from the 0% withholding income tax on interest. Offshore fundraising executed by means of the issuance of the so-called infrastructure debentures also benefit from the 0% rate of the withholding income tax, provided certain requirements are met. On top of that, certain tax treaties entered into by Brazil with other jurisdictions also provide a beneficial tax treatment for interest income paid out to foreign lenders.

Moreover, another tax advantage of foreign lender regards to the different treatment of the Tax on Financial Transactions in these cases. In effect, as a general rule, onshore loans with principal previously defined by the parties are impacted by the assessment of the Tax on Financial Transactions ("IOF/Credit"), which is generally levied at a daily 0.0041% rate, capped to 365 days, plus a flat 0.38%, thus leading to a combined 1.88% rate for transactions older than one year. On the other hand, cross-border loans whose average maturity term is set for a term longer than 181 days benefit from the 0% rate of the so-called IOF/FX – another modality of the Tax on Financial Transactions, which is triggered upon the execution of inbound/outbound FX transactions. However, the IOF/FX rate is increased to 6% if the loan average maturity term is lower than 181 days. Please note that FX transactions executed in connection with the payment of principal and interest by a Brazilian debt under a cross-border loan benefit from the 0% rate of the IOF/FX. Cross-border loans are not subject to the IOF/Credit.

6.3 Will any income of a foreign lender become taxable in your jurisdiction solely because of a loan to, or guarantee and/or grant of, security from a company in your jurisdiction?

As a general rule, no, since Brazilian tax rules concerning permanent establishments do not encompass cross-border lending transactions.

6.4 Will there be any other significant costs which would be incurred by foreign lenders in the grant of such loan/guarantee/security, such as notarial fees, etc.?

No. The tax impact to foreign lenders is generally limited to the withholding tax on income derived from the loans.

6.5 Are there any adverse consequences for a company that is a borrower (such as under thin capitalisation principles) if some or all of the lenders are organised under the laws of a jurisdiction other than your own? Please disregard withholding tax concerns for purposes of this question.

Under Brazilian tax regulations, certain tax constraints in respect to the tax-deductibility of interest expense at the level of the Brazilian debtor may apply, if the foreign lender is: (i) a related party to the Brazilian borrower; or (ii) located in a blacklisted (tax haven) or greylisted (privileged tax regime) low-tax jurisdiction. Such tax limitations mays apply due to (a) thin capitalisation, and (b) transfer pricing regulations.

Pursuant to current thin capitalisation rules, interest paid by sources located in Brazil to individuals or legal entities resident abroad will only be deductible for corporate tax purposes (IRPJ/CSL) if: (i) the debt with a related party (not located in a blacklisted jurisdiction) does not exceed two times the net equity of the Brazilian borrower (if the debt exceeds the threshold, the interest assessed on the excess amount will not be deductible); or (ii) the debts with entities located in a blacklisted jurisdiction does not exceed 30% of the net equity value of the legal entity resident in Brazil (if the debt exceeds the threshold, the interest assessed on the excess amount will not be deductible).

Cumulatively, one should also observe transfer pricing limits for the tax-deductibility expense arising from interest payments made to foreign lenders that are a related party to the borrower or located in black/greylisted jurisdictions. Under transfer pricing rules, depending on certain features of the relevant cross-border loan agreement, different tax-deductibility thresholds based on the interest of the contract shall apply: (i) for transactions denominated in US dollars at a fixed rate, the market rate for Brazilian government bonds issued in the foreign market, also in US dollars, will be adopted, plus a 3.5% spread; (ii) for transactions denominated in BRL at a fixed rate, the market rate for Brazilian government bonds issued in the foreign market in Brazilian Reais will be adopted, plus a 3.5% spread; and (iii) in other cases, the six-month LIBOR will be adopted, plus a 3.5% spread.

7 Judicial Enforcement

7.1 Will the courts in your jurisdiction recognise a governing law in a contract that is the law of another jurisdiction (a "foreign governing law")? Will courts in your jurisdiction enforce a contract that has a foreign governing law?

Yes, Brazilian courts would recognise a foreign governing law in an agreement, provided that such law does not offend Brazilian national sovereignty, public policy or good morals.

7.2 Will the courts in your jurisdiction recognise and enforce a judgment given against a company in New York courts or English courts (a "foreign judgment") without re-examination of the merits of the case?

If any final judgment of a court outside Brazil is rendered, such judgment would be recognised and enforced by the courts in Brazil without any retrial or re-examination of the merits of the original action, upon confirmation of that judgment by the Brazilian Superior Court of Justice (*Superior Tribunal de Justiça*). In order to be recognised by the Superior Court of Justice of Brazil, a foreign judgment must meet the following conditions: (i) it must comply with all formalities necessary for its enforcement under the laws of the jurisdiction where it was rendered; (ii) it must have been issued by a competent court after proper service of process on the parties, which service must comply with Brazilian Law if made in Brazil, or after sufficient evidence of the parties' absence has been given, as required by applicable law; (iii) it must be final and therefore not subject to appeal; (iv) it must not offend Brazilian national sovereignty, dignity of human being and/or public policy; (v) it must not violate a final and unappealable decision issued by a Brazilian court; (vi) it must not violate the exclusive jurisdiction of Brazilian courts; and (vii) it must be duly authenticated by the competent Brazilian consulate (except in case there is a bilateral agreement with the relevant country to waive such authentication by the Brazilian consulate or if apostilled in case the relevant country is signatory to the Hague Convention of 5 October 1961 Abolishing the Requirement of Legalisation for Foreign Public Documents and accompanied by a translation thereof into Portuguese, made by a certified translator in Brazil, except if waived by treaty.)

7.3 Assuming a company is in payment default under a loan agreement or a guarantee agreement and has no legal defence to payment, approximately how long would it take for a foreign lender to (a) assuming the answer to question 7.1 is yes, file a suit against the company in a court in your jurisdiction, obtain a judgment, and enforce the judgment against the assets of the company, and (b) assuming the answer to question 7.2 is yes, enforce a foreign judgment in a court in your jurisdiction against the assets of the company?

In Brazil it is very difficult to predict how long it takes for a court to render a decision over a lawsuit, as it varies between each city and, even in the same court, varies between each judge; nevertheless, it possible to estimate that, on average, in case of (a) above, it would take between two and three years and, in case of (b) above, around two years.

7.4 With respect to enforcing collateral security, are there any significant restrictions which may impact the timing and value of enforcement, such as (a) a requirement for a public auction, or (b) regulatory consents?

As regards pledges and fiduciary sale/assignment, if the debtor defaults pursuant to the security documents or the main agreement, the trustee owner, security trustee or creditor should notify him of the delay (through a simple registered letter, by a registered letter issued by the Registry of Deeds and Documents or bill of protest) and may sell the assets to third parties, irrespective of public sale, auction or any other judicial or extrajudicial measure.

As regards mortgages, in case the debtor defaults under the debt, in the absence of an insolvency scenario, the foreclosure proceeding for mortgages shall be the following: (i) upon default, the debtor is summoned to pay the debt plus interest, monetary correction, court costs and attorneys' fees within the cure period determined by the relevant security agreement. If the debtor does not perform its payment obligations within said period, the attached property shall be foreclosed; (ii) the next step is the appraisal of the attached property; (iii) at this stage, creditor may opt for adjudication (i.e. judicially transferring the asset's property and possession to the creditor) of the property for the value of appraisal (if the appraisal amount is lower than debt amount, the creditor would still have an unsecured claim over the remaining amount); (iv) if the creditor does not opt for adjudication, the next step is the out-of-court sale; (v) the out-of-court sale shall take place through two public auctions: (a) in the 1st public auction, real estate property must be sold by at least its appraisal value; or (b) in the 2nd public auction, real estate property must be sold by at least a fair (non-vile) amount; (vi) if the property is not sold in the first and second auctions a new option of adjudication of the property by creditor may be determined (at the discretion of the court); and (vii) no "mutual release" event is verified in mortgage foreclosures. Thus, if upon the sale of the real estate property or its adjudication the debt amount is not totally repaid to the creditor, the creditor still has an unsecured claim against the debtor for the remaining amounts due under the credit transaction (and other guarantees may be foreclosed).

7.5 Do restrictions apply to foreign lenders in the event of (a) filing suit against a company in your jurisdiction, or (b) foreclosure on collateral security?

Any plaintiff not resident in Brazil will be required to place a bond as security for court costs and for third party attorneys' fees if it does not possess any real property in Brazil, except in case of collection claims based on an instrument that may be enforced in Brazilian courts without review of its merits (*título executivo extrajudicial*) or counterclaims.

7.6 Do the bankruptcy, reorganisation or similar laws in your jurisdiction provide for any kind of moratorium on enforcement of lender claims? If so, does the moratorium apply to the enforcement of collateral security?

Within the context of bankruptcy proceedings, there is an automatic stay which derives from the decision which actually declares the bankruptcy. In this sense, bankruptcy declaration stays the course for all judicial actions and enforcements against the guarantor. Accordingly, to the extent bankruptcy proceedings – in principle – attach to all the guarantor's creditors, the secured party holding the collateral will be affected by the automatic stay of bankruptcy proceedings. In this scenario, the assets constituting the collateral will not be delivered to the secured party for payment of the secured debt. More significantly, the secured party will not be able to take any legal action to enforce and liquidate the collateral. The assets given in collateral will be gathered by the trustee for subsequent liquidation and payment of creditors that eventually hold a privilege or preference.

Within the context of judicial reorganisation proceedings, the automatic stay derives from the court decision that grants the processing of the judicial reorganisation application filed by the guarantor. Granting of the judicial reorganisation proceedings stays the course for all legal actions and enforcements proceedings against the guarantor related to all creditors subject to/affected by the judicial reorganisation proceedings. Under no circumstances can the automatic stay in judicial reorganisation proceedings exceed 180 days.

Within the context of extra-judicial reorganisation proceedings, the mere filing of such procedure does not entail the suspension of any court proceedings against the guarantor.

7.7 Will the courts in your jurisdiction recognise and enforce an arbitral award given against the company without re-examination of the merits?

Yes. Please refer to the answer to question 7.2.

8 Bankruptcy Proceedings

8.1 How does a bankruptcy proceeding in respect of a company affect the ability of a lender to enforce its rights as a secured party over the collateral security?

Under judicial reorganisation, upon the filing, the Court will eventually accept the filing and grant the processing order ("Processing Order"). As a result of the Processing Order, the debtor enjoys a stay period of 180 calendar days ("Stay Period"). During the Stay Period, all actions, enforcement and foreclosure proceedings against the debtor are generally stayed (or cannot be commenced). The Stay Period is designed to provide the debtor with breathing room to formulate, negotiate and eventually obtain creditors' support and approval of a Plan of Reorganisation. During the Stay Period, creditors holding collateral in the form of a fiduciary lien (a bankruptcy-remote collateral) are not entitled to remove the respective asset from the debtor's possession in case such asset is deemed to be essential to the debtor's activities.

Further, in case bankruptcy liquidation is adjudicated, as a rule all assets should be scheduled by the court-appointed trustee to be subsequently sold. Creditors holding securities in the form of a fiduciary lien should be entitled to remove the respective asset from the bankrupt estate through the filing of a claim for restitution, as the case may be.

8.2 Are there any preference periods, clawback rights or other preferential creditors' rights (e.g., tax debts, employees' claims) with respect to the security?

The Brazilian Bankruptcy Law ("BBL") regulates scenarios where antecedent transactions are deemed ineffective or voidable. Indeed, certain specific acts and contracts performed under a statutory period before the adjudication of the debtor's bankruptcy liquidation (*falência*) are considered ineffective. Further, acts performed with the intent to hinder or defraud creditors may also be declared null and void.

Section 129 of the BBL establishes that certain acts performed during a claw-back (look-back) period (*termo legal*) shall be declared ineffective in relation to the estate. The claw-back can generally retroactively apply up to 90 days prior to: (a) the filing of a bankruptcy liquidation (involuntary) request by the debtor's creditor; (b) the filing for court-protection under judicial reorganisation (in case judicial reorganisation has been subsequently converted into bankruptcy liquidation proceedings); or (c) outstanding protest of a debtor's title due to lack of payment.

Ineffectiveness declaration should apply regardless of whether the involved parties were aware of the financial condition of the debtor or had the intention to defraud creditors. The following actions (*inter alia*), if consummated during the claw-back period, shall be considered objectively ineffective: (i) payment of unmatured obligations (i.e. preferred payment); (ii) payment of matured obligations in a different manner than originally established by the parties in the relevant contracts; and (iii) creation of collateral (security) to secure an existing unsecured debt. The transfer of substantially all of a debtor's assets shall also be ineffective if consummated without consent or payment of all creditors existing at the time of the transfer.

In addition, transactions implemented before or after the debtor's bankruptcy liquidation adjudication (including the implementation of a security) may be revoked through the filing of a claw-back lawsuit (*ação recocatória*) if they were performed fraudulently, irrespective of whether they were committed during the claw-back period. Indeed, section 130 of the BBL establishes that acts performed with the intent to defraud creditors may be revoked, provided there is evidence of (i) fraudulent collusion between the debtor and the contracting third party, and (ii) actual loss suffered by the estate.

8.3 Are there any entities that are excluded from bankruptcy proceedings and, if so, what is the applicable legislation?

The BBL (which regulates bankruptcy liquidation proceedings) does not apply to government-owned entities, mixed-capital companies, public or private financial institutions, credit unions, consortia, supplementary pension companies, healthcare plan companies, insurance companies and special saving companies.

Financial institutions' insolvency (except federal institutions) is regulated by Law No. 6,024/74, which contemplates the intervention and extrajudicial liquidation regimes. Ultimately, both the intervention and extrajudicial liquidation may be converted to bankruptcy liquidation as regulated by the BBL, as the case may be.

Other regulated entities, such as healthcare plan companies and insurance companies, will follow insolvency proceedings as established before the respective regulatory framework, as applicable.

8.4 Are there any processes other than court proceedings that are available to a creditor to seize the assets of a company in an enforcement?

Although certain types of fiduciary lien collaterals may be foreclosed in an extra judicial basis, in a contested case a creditor should necessarily resort to in-court proceedings to seize and expropriate assets of the debtor in the context of an enforcement proceeding.

9 Jurisdiction and Waiver of Immunity

9.1 Is a party's submission to a foreign jurisdiction legally binding and enforceable under the laws of your jurisdiction?

The submission of a party to the non-exclusive jurisdiction of a foreign jurisdiction is legal, valid and binding under the laws of Brazil and will be accepted by the Brazilian courts, subject to certain assumptions and qualifications.

9.2 Is a party's waiver of sovereign immunity legally binding and enforceable under the laws of your jurisdiction?

Generally, no non-public owned entities have immunity from suit, proceedings, the enforcement of any judgment, any attachment or from any other legal process (whether on the grounds of sovereign immunity or otherwise) under Brazilian law in respect of their respective obligations under the pledge agreements.

10 Licensing

10.1 What are the licensing and other eligibility requirements in your jurisdiction for lenders to a company in your jurisdiction, if any? Are these licensing and eligibility requirements different for a "foreign" lender (i.e. a lender that is not located in your jurisdiction)? In connection with any such requirements, is a distinction made under the laws of your jurisdiction between a lender that is a bank *versus* a lender that is a non-bank? If there are such requirements in your jurisdiction, what are the consequences for a lender that has not satisfied such requirements but has nonetheless made a loan to a company in your jurisdiction? What are the licensing and other eligibility requirements in your jurisdiction for an agent under a syndicated facility for lenders to a company in your jurisdiction?

Any individual or legal entity may enter into a loan agreement subject to certain interest limitations in case the lender is not a financial entity under the supervision of the Central Bank. Therefore, only financial entities have the authorisation to extend loans without pre-defined limits on interest rates. It is a criminal offence in Brazil to carry out any activity that is reserved exclusively for financial institutions. Generally, no specific requirements apply for agents (*trustees*) in syndicated facilities.

Treatment for corporate lending activities under Brazilian law is different depending on whether the transactions are domestic or made offshore.

If the corporate lending transaction is entered into by a Brazilian counterparty with an offshore financial institution, such transactions (direct foreign loans) shall observe Law No. 4131, of September 3, 1962, Brazilian Monetary Council Resolution No. 3.844, of March 23, 2010, and Central Bank Circular No. 3.491, of March 24, 2010.

Such regulations expressly allow legal entities located in Brazil to contract loans with legal entities located abroad. In this case, the funds raised abroad by Brazilian entities should be necessarily invested in "economic activities", although the regulations have not defined such a concept. It is, however, generally understood that such funds obtained abroad should not be used for speculative purposes in Brazil.

Considering that, as long as the loan is contracted in accordance with the applicable regulation, it will not constitute the carrying on of the business of banking in Brazil, nor will it subject the lender (or any of its affiliates) to any oversight by the Brazilian regulatory authorities.

Apart from that mentioned herein, loan transactions do not require any approval from, or notice to, any Brazilian regulatory authority. However, it is important to mention that although no physical documents are involved in the Central Bank registration process, the Brazilian debtor shall keep the loan agreement (and guarantees, if any) in its files for five years as from the date when the loan is granted.

11 Other Matters

11.1 Are there any other material considerations which should be taken into account by lenders when participating in financings in your jurisdiction?

There are no further considerations that need to be mentioned.

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British Virgin Islands

Michael Gagie

Maples Group

Matthew Gilbert

1 Overview

1.1 What are the main trends/significant developments in the lending markets in your jurisdiction?

The British Virgin Islands continues to be a jurisdiction of choice for corporate vehicles entering into secured finance transactions, and remains a markedly creditor-friendly jurisdiction. Recent amendments to the key corporate legislation, the BVI Business Companies Act (as amended) (the "**Act**") have enhanced the protection of secured creditors including on a continuation of the domicile of a BVI company out of the BVI and into another jurisdiction, and on a liquidation, where the liquidator now has an express statutory obligation to give effect to the rights and priority of the claims of the company's secured creditors. In line with commercial practice, the amendments to the Act have also provided greater flexibility and certainty for the execution of deeds, which from a practical perspective will assist virtual closings. The amendments to the Act also tightened record-keeping obligations on companies. The jurisdiction has implemented the OECD Common Reporting Standards.

1.2 What are some significant lending transactions that have taken place in your jurisdiction in recent years?

British Virgin Islands obligors continue to feature prominently in financed holding structures and joint ventures, notably: in the oil and gas and mining sectors; in development finance and infrastructure projects throughout Africa, Asia and Eastern Europe, CIS, Latin America and elsewhere; in high-end property developments in London; and in shipping, drillships and other asset finance facilities.

2 Guarantees

2.1 Can a company guarantee borrowings of one or more other members of its corporate group (see below for questions relating to fraudulent transfer/financial assistance)?

The giving of a guarantee by a British Virgin Islands company is governed by the Act, and the company's memorandum and articles of association. Subject to its memorandum and articles of association, the powers of a company include (among other things) the power to guarantee a liability or obligation of any person and secure any obligations by mortgage, pledge or other charge of any of its assets for that purpose.

2.2 Are there enforceability or other concerns (such as director liability) if only a disproportionately small (or no) benefit to the guaranteeing/securing company can be shown?

Under the Act, and subject to its memorandum and articles of association, a company has, irrespective of corporate benefit, full capacity to carry on or undertake any business or activity, do any act or enter any transaction and, for those purposes, full rights, powers and privileges.

The directors of a company have fiduciary and statutory duties to act honestly and in good faith and in the best interests of the company. A director who is in breach of his duties may be liable to the company for the resulting loss to the company.

In the event that there is a disproportionately small (or no) benefit to the company, the transaction may be open to challenge, for example as a transaction at an undervalue, in the event of the insolvency of the company (see below).

2.3 Is lack of corporate power an issue?

Under the Act, no act of a company and no transfer of an asset by or to a company is invalid by reason only of the fact the company did not have the capacity, right or power to perform the act or to transfer or receive the asset.

It should be noted that members' remedies have been codified in the Act, and, for example, if a company or a director of a company engages in, proposes to engage in, or has engaged in conduct that contravenes the Act or the memorandum or articles of the company, the British Virgin Islands court may, on the application of a member or a director of the company, make an order directing the company or director to comply with, or restraining the company or director from engaging in conduct that contravenes the Act or the memorandum or articles.

2.4 Are any governmental or other consents or filings, or other formalities (such as shareholder approval), required?

It is not necessary to ensure the legality, validity, enforceability or admissibility in evidence of a guarantee that any document be filed, recorded or enrolled with any governmental authority or agency or any official body in the British Virgin Islands. Shareholder approval would be required only in the event the company's memorandum and articles of association require it.

2.5 Are net worth, solvency or similar limitations imposed on the amount of a guarantee?

To the extent that, under the applicable governing law, the guarantee is characterised as a debt incurred on behalf of a member of the company, it may be deemed to be a distribution and accordingly be subject to the requirement of the directors to determine that the company will pass the basic solvency test immediately after the deemed distribution. Under the solvency test, the company's assets must exceed its liabilities and the company must be able to pay its debts as they fall due. For former International Business Companies that still have a share capital, the requirements for satisfying the solvency test differ.

2.6 Are there any exchange control or similar obstacles to enforcement of a guarantee?

There is no exchange control legislation under British Virgin Islands law and accordingly there are no exchange control regulations imposed under British Virgin Islands law.

3 Collateral Security

3.1 What types of collateral are available to secure lending obligations?

There are no limits under British Virgin Islands law on the types of collateral that a company may give.

3.2 Is it possible to give asset security by means of a general security agreement or is an agreement required in relation to each type of asset? Briefly, what is the procedure?

A company may enter into a general security agreement such as a debenture.

3.3 Can collateral security be taken over real property (land), plant, machinery and equipment? Briefly, what is the procedure?

It should be noted that assets would typically be held outside the British Virgin Islands and collateral instruments would typically be governed by a governing law relevant to the jurisdiction in which the asset is sited. In the event that the company holds an interest in real estate or other assets physically located in the British Virgin Islands, there are certain licensing, registration and stamp duty considerations.

3.4 Can collateral security be taken over receivables? Briefly, what is the procedure? Are debtors required to be notified of the security?

British Virgin Islands law does not make statutory provision for an assignment by way of security. An assignment of receivables governed by British Virgin Islands law would require the written agreement of the debtor in order to take effect as a legal assignment, failing which the assignee would likely take an equitable assignment only.

3.5 Can collateral security be taken over cash deposited in bank accounts? Briefly, what is the procedure?

A company may give security over cash held in its bank accounts in any jurisdiction. British Virgin Islands law does not make statutory provision for collateral security over cash deposited in bank accounts located in the British Virgin Islands, and the cooperation of the account holding branch would be required.

3.6 Can collateral security be taken over shares in companies incorporated in your jurisdiction? Are the shares in certificated form? Can such security validly be granted under a New York or English law governed document? Briefly, what is the procedure?

Collateral security may be taken over shares in companies incorporated in the British Virgin Islands and this is a popular and frequently used type of security. Such security can validly be granted under a foreign law-governed document, and New York or English law-governed security is common. In the case of an English law-governed document, the application of the Financial Collateral Arrangements (No 2) Regulations 2003 to shares in a British Virgin Islands company has been confirmed by the Privy Council in *Cukurova Finance International Limited and Cukurova Holdings A.S (Appellants) v Alfa Telecom Turkey Ltd (Respondent)* [2013] UKPC 2. Shares are in registered form and share security is typically taken by way of an equitable mortgage. The Act provides a mechanism for particulars of a charge over shares to be noted on the register of members, a copy of which the company may file publicly at the Registry of Corporate Affairs in order for a person carrying out a company search to be on notice of the equitable security. The Act now enables a chargee to enforce immediately upon an event of default. The Act also provides for the powers of the chargee or a receiver which may be modified or supplemented by the security instrument.

3.7 Can security be taken over inventory? Briefly, what is the procedure?

A company may give security over inventory. The applicable procedure would be driven by the jurisdiction in which the inventory is located.

3.8 Can a company grant a security interest in order to secure its obligations (i) as a borrower under a credit facility, and (ii) as a guarantor of the obligations of other borrowers and/or guarantors of obligations under a credit facility (see below for questions relating to the giving of guarantees and financial assistance)?

Subject to its memorandum and articles of association, a company may grant a security interest to secure its obligations as a borrower, or the obligations of others.

3.9 What are the notarisation, registration, stamp duty and other fees (whether related to property value or otherwise) in relation to security over different types of assets?

No steps are required as a matter of British Virgin Islands law to perfect a security interest where assets are not located in the British Virgin Islands. It is a requirement of the Act that a company keep a register of all relevant charges created by the company, either at the company's registered office, or at the office of the company's registered agent. For the purposes of priority, an application may be made to the Registrar to register the charges created, providing an advantage to secured creditors that is not available in some offshore jurisdictions. Subject to such registration, and any prior security interests registered on the applicable register, the security interest will, as a matter of British Virgin Islands law, have priority over any claims by third parties (other than those preferred by law) including any liquidator or a creditor of the company, subject in the case of a winding up of the company in a jurisdiction other than the British Virgin Islands to any provisions of the laws of that jurisdiction as to priority of claims in a winding up. A floating charge will rank behind a subsequently registered fixed charge unless the floating charge contains a prohibition or restriction on the power of the company to create any future security interest ranking ahead in priority to or equally with the floating charge.

No taxes, fees or charges (including stamp duty) are payable (either by direct assessment or withholding) to the government or other taxing authority in the British Virgin Islands under the laws of the British Virgin Islands in respect of the execution or delivery, or the enforcement, of security documentation. In the event that the company holds an interest in real estate or other assets physically located in the British Virgin Islands, there are certain perfection, licensing, registration and stamp duty considerations.

3.10 Do the filing, notification or registration requirements in relation to security over different types of assets involve a significant amount of time or expense?

The Registry of Corporate Affairs fee for registering a register of charges is US$200. A small amount of time will be required for the preparation of the particulars of the registration.

3.11 Are any regulatory or similar consents required with respect to the creation of security?

No, they are not.

3.12 If the borrowings to be secured are under a revolving credit facility, are there any special priority or other concerns?

No, there are not.

3.13 Are there particular documentary or execution requirements (notarisation, execution under power of attorney, counterparts, deeds)?

No, there are not.

4 Financial Assistance

4.1 Are there prohibitions or restrictions on the ability of a company to guarantee and/or give security to support borrowings incurred to finance or refinance the direct or indirect acquisition of: (a) shares of the company; (b) shares of any company which directly or indirectly owns shares in the company; or (c) shares in a sister subsidiary?

(a) Shares of the company

Subject to its memorandum or articles, the powers of a company include the power to give financial assistance to any person in connection with the acquisition of its own shares.

(b) Shares of any company which directly or indirectly owns shares in the company

There are no restrictions on the giving of financial assistance to any person in connection with the acquisition of shares of any company which directly or indirectly owns shares in the company.

(c) Shares in a sister subsidiary

There are no restrictions on the giving of financial assistance to any person in connection with the acquisition of shares in a sister subsidiary.

5 Syndicated Lending/Agency/Trustee/Transfers

5.1 Will your jurisdiction recognise the role of an agent or trustee and allow the agent or trustee (rather than each lender acting separately) to enforce the loan documentation and collateral security and to apply the proceeds from the collateral to the claims of all the lenders?

The British Virgin Islands courts will recognise the role of an agent or trustee and allow the agent or trustee (rather than each lender acting separately) to enforce the loan documentation and collateral security and to apply the proceeds from the collateral to the claims of all the lenders, where that is provided for pursuant to the provisions of the applicable security documentation.

5.2 If an agent or trustee is not recognised in your jurisdiction, is an alternative mechanism available to achieve the effect referred to above which would allow one party to enforce claims on behalf of all the lenders so that individual lenders do not need to enforce their security separately?

This is not necessary in the British Virgin Islands.

5.3 Assume a loan is made to a company organised under the laws of your jurisdiction and guaranteed by a guarantor organised under the laws of your jurisdiction. If such loan is transferred by Lender A to Lender B, are there any special requirements necessary to make the loan and guarantee enforceable by Lender B?

This would be dependent on the applicable governing laws of the loan and the assignment documentation. British Virgin Islands law does not make statutory provision for the assignment of intangibles. An assignment of receivables governed by British Virgin Islands law would require the written agreement of the debtor in order to take effect as a legal assignment, failing which the assignee would likely take an equitable assignment only. A deed of novation would more typically be used to transfer a loan governed by British Virgin Islands law.

6 Withholding, Stamp and Other Taxes; Notarial and Other Costs

6.1 Are there any requirements to deduct or withhold tax from (a) interest payable on loans made to domestic or foreign lenders, or (b) the proceeds of a claim under a guarantee or the proceeds of enforcing security?

No taxes are required to be deducted or withheld under the laws of the British Virgin Islands from (a) interest payable on loans made to domestic or foreign lenders, or (b) the proceeds of a claim under a guarantee or the proceeds of enforcing security. The British Virgin Islands complies with the EU Taxation of Savings Directive through the automatic exchange of information on savings income with tax authorities in EU Member States.

6.2 What tax incentives or other incentives are provided preferentially to foreign lenders? What taxes apply to foreign lenders with respect to their loans, mortgages or other security documents, either for the purposes of effectiveness or registration?

No taxes are payable to the government or other taxing authority in the British Virgin Islands under the laws of the British Virgin Islands in respect of the execution or delivery, or the enforcement, of security documentation. In the event that the company holds an interest in real estate or other assets physically located in the British Virgin Islands, there are certain perfection, licensing, registration and stamp duty considerations.

6.3 Will any income of a foreign lender become taxable in your jurisdiction solely because of a loan to, or guarantee and/or grant of, security from a company in your jurisdiction?

No income of a foreign lender will become taxable in the British Virgin Islands solely because of a loan to, or guarantee and/or grant of security from, a company in the British Virgin Islands.

6.4 Will there be any other significant costs which would be incurred by foreign lenders in the grant of such loan/guarantee/security, such as notarial fees, etc.?

There are no significant costs such as notarial fees which would be incurred by foreign lenders in a loan to or guarantee and/or grant of security from a company in the British Virgin Islands.

6.5 Are there any adverse consequences for a company that is a borrower (such as under thin capitalisation principles) if some or all of the lenders are organised under the laws of a jurisdiction other than your own? Please disregard withholding tax concerns for purposes of this question.

No, there are not.

7 Judicial Enforcement

7.1 Will the courts in your jurisdiction recognise a governing law in a contract that is the law of another jurisdiction (a "foreign governing law")? Will courts in your jurisdiction enforce a contract that has a foreign governing law?

The British Virgin Islands courts will recognise a governing law that is the law of another jurisdiction, subject to the considerations applicable generally to choice of law provisions.

The British Virgin Islands courts may decline to exercise jurisdiction in relation to substantive proceedings brought under or in relation to a contract that has a foreign governing law in matters where they determine that such proceedings may be tried in a more appropriate forum.

7.2 Will the courts in your jurisdiction recognise and enforce a judgment given against a company in New York courts or English courts (a "foreign judgment") without re-examination of the merits of the case?

Any final and conclusive monetary judgment obtained against a company in the courts of England and Wales, for a definite sum, may be registered and enforced as a judgment of the British Virgin Islands court if application is made for registration of the judgment within 12 months or such longer period as the court may allow, and if the British Virgin Islands court considers it just and convenient that the judgment be so enforced. Alternatively, the judgment may be treated as a cause of action in itself so that no retrial of the issues would be necessary. In either case, it will be necessary that in respect of the foreign judgment:

(a) the foreign court issuing the judgment had jurisdiction in the matter and the judgment debtor either submitted to such jurisdiction or was resident or carrying on business within such jurisdiction and was duly served with process;

(b) the judgment given by the foreign court was not in respect of penalties, taxes, fines or similar fiscal or revenue obligations of the company;

(c) in obtaining judgment there was no fraud on the part of the person in whose favour judgment was given, or on the part of the foreign court;

(d) recognition or enforcement of the judgment in the British Virgin Islands would not be contrary to public policy;

(e) the proceedings pursuant to which judgment was obtained were not contrary to natural justice; and

(f) the judgment given by the foreign court is not the subject of an appeal.

Any final and conclusive monetary judgment obtained against a company in the courts of New York, for a definite sum, may be treated by the British Virgin Islands courts as a cause of action in itself so that no retrial of the issues would be necessary, provided that in respect of the foreign judgment:

(a) the foreign court issuing the judgment had jurisdiction in the matter and the company either submitted to such jurisdiction or was resident or carrying on business within such jurisdiction and was duly served with process;

(b) the judgment given by the foreign court was not in respect of penalties, taxes, fines or similar fiscal or revenue obligations of the company;

(c) there was no fraud on the part of the person in whose favour judgment was given or on the part of the court, in obtaining judgment;

(d) recognition or enforcement of the judgment in the British Virgin Islands would not be contrary to public policy; and

(e) the proceedings pursuant to which judgment was obtained were not contrary to natural justice.

7.3 Assuming a company is in payment default under a loan agreement or a guarantee agreement and has no legal defence to payment, approximately how long would it take for a foreign lender to (a) assuming the answer to question 7.1 is yes, file a suit against the company in a court in your jurisdiction, obtain a judgment, and enforce the judgment against the assets of the company, and (b) assuming the answer to question 7.2 is yes, enforce a foreign judgment in a court in your jurisdiction against the assets of the company?

There is no set timetable for such proceedings, and the time involved will depend on the nature of the enforcement proceedings (for example, an application to appoint liquidators on the ground of insolvency may be quicker than an action of judgment on the debt claim). If there is no defence to the claim and it is unopposed, judgment may be obtained in proceedings against a British Virgin Islands company in approximately one month from the commencement of proceedings. If the proceedings are defended, then the time involved will depend upon the facts and circumstances of the case. Broadly, the same considerations apply to an application to enforce a foreign judgment in the British Virgin Islands.

7.4 With respect to enforcing collateral security, are there any significant restrictions which may impact the timing and value of enforcement, such as (a) a requirement for a public auction, or (b) regulatory consents?

No, there are not.

7.5 Do restrictions apply to foreign lenders in the event of (a) filing suit against a company in your jurisdiction, or (b) foreclosure on collateral security?

There are no restrictions applicable to foreign lenders.

7.6 Do the bankruptcy, reorganisation or similar laws in your jurisdiction provide for any kind of moratorium on enforcement of lender claims? If so, does the moratorium apply to the enforcement of collateral security?

The appointment of liquidators against a company under the BVI Insolvency Act, 2003 (as amended) (the "**Insolvency Act**") brings about a moratorium on claims against the company, but this does not prevent the enforcement of security.

7.7 Will the courts in your jurisdiction recognise and enforce an arbitral award given against the company without re-examination of the merits?

Under the Arbitration Act 2013, the United Kingdom and British Virgin Islands arbitral awards will now be treated in the British Virgin Islands as New York Convention awards. The British Virgin Islands is a party to the New York Convention on the Recognition and Enforcement of Foreign Arbitral Awards 1958 (the "**Convention**"). A court in the British Virgin Islands is required by law to enforce, without re-examination of the merits of the case or re-litigation of the matters arbitrated upon, a Convention award. However, enforcement of a Convention award may be refused if the person against whom it is invoked proves:

(a) that a party to the arbitration agreement was, under the law applicable to him, under some incapacity;

(b) that the arbitration agreement was not valid under the law to which the parties subjected it or, failing any indication thereon, under the law of the country where the award was made;

(c) that he was not given proper notice of the appointment of the arbitrator or of the arbitration proceedings or was otherwise unable to present his case;

(d) that the award deals with a difference not contemplated by or not falling within the terms of the submission to arbitration or contains decisions on matters beyond the scope of the submission to arbitration;

(e) that the composition of the arbitral authority or the arbitral procedure was not in accordance with the agreement of the parties or failing such agreement, with the law of the country where the arbitration took place; or

(f) that the award has not yet become binding on the parties, or has been set aside or suspended by a competent authority of the country in which, or under the law of which, it was made.

Enforcement of a Convention award may also be refused if the award is in respect of a matter which is not capable of settlement by arbitration under the laws of the British Virgin Islands, or if it would be contrary to public policy to enforce the award.

A Convention award which contains decisions on matters not submitted to arbitration may be enforced to the extent that it contains decisions on matters submitted to arbitration which can be separated from those on matters not so submitted.

8 Bankruptcy Proceedings

8.1 How does a bankruptcy proceeding in respect of a company affect the ability of a lender to enforce its rights as a secured party over the collateral security?

Security over the assets of a company in liquidation may be enforced by the chargee directly over those assets, which fall outside the custody and control of the liquidator.

8.2 Are there any preference periods, clawback rights or other preferential creditors' rights (e.g., tax debts, employees' claims) with respect to the security?

In the event of the insolvency of a company, there are four types of voidable transaction provided for in the Insolvency Act:

1. Unfair Preferences: Under section 245 of the Insolvency Act, a transaction entered into by a company, if it is entered into within the hardening period (see below) at a time when the company is insolvent, or it causes the company to become insolvent (an "**insolvency transaction**"), and which has the effect of putting the creditor into a position which, in the event of the company going into insolvent liquidation, will be better than the position it would have been in if the transaction had not been entered into, will be deemed an unfair preference. A transaction is not an unfair preference if the transaction took place in the ordinary course of business. It should be noted that this provision applies regardless of whether the payment or transfer is made for value or at an undervalue.
2. Undervalue Transactions: Under section 246 of the Insolvency Act, the making of a gift or the entering into of a transaction on terms that the company is to receive no consideration, or where the value of the consideration for the transaction, 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 will (if it is an insolvency transaction entered into within the hardening period) be deemed an undervalue transaction. A company does not enter into a transaction at an undervalue if it is entered into in good faith and for the purposes of its business and, at the time the transaction was entered into, there were reasonable grounds for believing the transaction would benefit the company.
3. Voidable Floating Charges: Under section 247 of the Insolvency Act a floating charge created by a company is voidable if it is an insolvency transaction created within the hardening period. A floating charge is not voidable to the extent that it secures:

   (a) money advanced or paid to the company, or at its direction, at the same time as, or after, the creation of the charge;

   (b) the amount of any liability of the company discharged or reduced at the same time as, or after, the creation of the charge;

(c) the value of assets sold or supplied, or services supplied, to the company at the same time as, or after, the creation of the charge; and

(d) the interest, if any, payable on the amount referred to in (a) to (c) pursuant to any agreement under which the money was advanced or paid, the liability was discharged or reduced, the assets were sold or supplied or the services were supplied.

4. Extortionate Credit Transactions: Under section 248 of the Insolvency Act, an insolvency transaction entered into by a company for, or involving the provision of, credit to the company, may be regarded as an extortionate credit transaction if, having regard to the risk accepted by the person providing the credit, the terms of the transaction are or were such to require grossly exorbitant payments to be made in respect of the provision of the credit, or the transaction otherwise grossly contravenes ordinary principles of fair trading and such transaction takes place within the hardening period.

The hardening period (known in the Insolvency Act as the vulnerability period) in respect of each voidable transaction provision set out above is as follows:

(a) for the purposes of sections 245, 246 and 247 of the Insolvency Act, the period differs depending on whether the person(s) that the transaction is entered into with, or the preference is given to, are connected persons of the company within the meaning of the Insolvency Act. In the case of connected persons, the hardening period is the period beginning two years prior to the onset of insolvency (see below) and ending on the appointment of a liquidator of the company. In the case of any other person, the hardening period is the period beginning six months prior to the onset of insolvency and ending on the appointment of a liquidator of the company; and

(b) for the purposes of section 248 of the Insolvency Act, the hardening period is the period beginning five years prior to the onset of insolvency and ending on the appointment of a liquidator of the company regardless of whether the person(s) that the transaction is entered into with is a connected person.

The onset of insolvency for these purposes is the date on which an application for the appointment of a liquidator was filed (if the liquidator was appointed by the Court) or the date of the appointment of the liquidator (where the liquidator was appointed by the members).

A conveyance made by a person with intent to defraud creditors is voidable at the instance of the person thereby prejudiced. There is no requirement that the relevant transaction was entered into at a time when one party was insolvent or became insolvent as a result of the transaction, and there is no requirement that the transferring party subsequently went into liquidation. However, no conveyance entered into for valuable consideration and in good faith to a person who did not have notice of the intention to defraud may be impugned.

There are limited preferential creditors under British Virgin Islands law.

8.3 Are there any entities that are excluded from bankruptcy proceedings and, if so, what is the applicable legislation?

Certain sovereign entities and treaty-based organisations are protected. For example, the State Immunity (Overseas Territories) Order 1979 extended the State Immunity Act 1978 to the British Virgin Islands, and the International Finance Corporation Order 1955 extends to the British Virgin Islands.

8.4 Are there any processes other than court proceedings that are available to a creditor to seize the assets of a company in an enforcement?

Enforcement of a charge over the shares in a British Virgin Islands company could be effected without recourse to the courts, where the necessary documentation has been provided by the chargor, the issuer company and the registered agent prior to the date of enforcement. As stated above, the remedy of appropriation that may be contained in an English law-governed share charge has been upheld by the Privy Council as applicable to shares in a British Virgin Islands company.

9 Jurisdiction and Waiver of Immunity

9.1 Is a party's submission to a foreign jurisdiction legally binding and enforceable under the laws of your jurisdiction?

The British Virgin Islands courts will recognise that a foreign jurisdiction may be the more appropriate forum for enforcement.

9.2 Is a party's waiver of sovereign immunity legally binding and enforceable under the laws of your jurisdiction?

A relevant entity may waive immunity pursuant to the State Immunity Act 1978.

10 Licensing

10.1 What are the licensing and other eligibility requirements in your jurisdiction for lenders to a company in your jurisdiction, if any? Are these licensing and eligibility requirements different for a "foreign" lender (i.e. a lender that is not located in your jurisdiction)? In connection with any such requirements, is a distinction made under the laws of your jurisdiction between a lender that is a bank versus a lender that is a non-bank? If there are such requirements in your jurisdiction, what are the consequences for a lender that has not satisfied such requirements but has nonetheless made a loan to a company in your jurisdiction? What are the licensing and other eligibility requirements in your jurisdiction for an agent under a syndicated facility for lenders to a company in your jurisdiction?

Assuming that the lender is not doing business in the British Virgin Islands, it will not be caught by the regulatory legislation, or requirements for licensing, in the jurisdiction. Significantly, business is not carried on "in the British Virgin Islands" by a lender by reason only of it being carried on with a company or limited partnership incorporated or registered in the British Virgin Islands.

A "foreign" lender, which does not carry on business in the British Virgin Islands, would not be required to be licensed in order to lend to a British Virgin Islands company.

There is no distinction between a lender that is a bank *versus* a lender that is a non-bank.

In the unlikely event that, based on the facts of a specific scenario, a foreign lender is found to be carrying on business in the British Virgin Islands without holding the requisite licence, the loan may be unenforceable by the lender.

As above, assuming that the agent is not conducting business in the British Virgin Islands, there are no licensing and eligibility requirements for an agent under a syndicated facility.

11 Other Matters

11.1 Are there any other material considerations which should be taken into account by lenders when participating in financings in your jurisdiction?

The British Virgin Islands is a dependable common law jurisdiction, and other attractions for lenders not mentioned above include, for example, the statutory recognition of netting, set off and subordination arrangements, and the ability for a creditor to restore a dissolved company where it is just to do so.

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Canada

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1 Overview

1.1 What are the main trends/significant developments in the lending markets in your jurisdiction?

Canadian banks have been widely recognised internationally as well-capitalised, well-managed and well-regulated, and a major contributing force in the Canadian economy. The lending market in Canada is characterised by a wide range of domestic banks, pension funds, credit unions and insurance companies, as well as major foreign banks and finance companies, offering a range of commercial lending services and financial products on par with those offered anywhere else in the world.

In recent years, there has been increasing growth of the private debt investor market in Canada. A number of newer non-bank funds and institutions have become active in mid-market leveraged lending and other lines of business. These opportunities have arisen in large part due to the increased regulatory burden and capital requirements faced by banks following the financial crisis. With continued active participation by Canadian banks as well as foreign lenders, and the increasing presence of non-bank lending funds, the Canadian lending market remains very competitive and lending margins remain tight.

Fintech lending also continues to grow in the Canadian market. At present, the regulation of fintech in Canada is generally fragmented and siloed. No single central authority regulates the wide variety of functions associated with fintech. In general, regulation is entity-based rather than function-based and is split between federal and provincial jurisdictions. Federal law covers banking and anti-money laundering, while provincial law governs such matters as securities, consumer protection and privacy. Both federal and provincial authorities are working towards developing more unified fintech strategies and are experimenting with such innovations as the regulatory sandbox to ease the regulatory burden for startups.

1.2 What are some significant lending transactions that have taken place in your jurisdiction in recent years?

One of the largest and most complex finance transactions in recent years was the restructuring of Frontera Energy Corporation (previously known as Pacific Exploration & Production Corporation), which involved, among other things, the conversion of approximately $5.4 billion of existing indebtedness into equity. Cross-border lending into Canada, particularly from the United States, remained active in 2018, including the financing of the acquisition of Trader Corporation, Canada's largest digital automotive marketplace and software solutions provider to automobile dealers, valued at approximated $1.6 billion. 2018 also witnessed the emergence from creditor protection of Algoma Steel Inc. (f/k/a Essar Steel Algoma Inc.) in a complex transaction involving a $1 billion deleveraging of the company's balance sheet with the consent of existing creditors, trade unions, both provincial and federal levels of government and a syndicate of new lenders. Lending in the public-private partnership (P3) space continued its momentum, especially as more provinces and municipalities are turning to the P3 model for funding their infrastructure projects.

2 Guarantees

2.1 Can a company guarantee borrowings of one or more other members of its corporate group (see below for questions relating to fraudulent transfer/financial assistance)?

Yes, it can.

2.2 Are there enforceability or other concerns (such as director liability) if only a disproportionately small (or no) benefit to the guaranteeing/securing company can be shown?

In some circumstances, the enforceability of a guarantee could be challenged by stakeholders on the basis that it was granted in a manner that was oppressive, unfairly prejudicial or that unfairly disregards the interest of creditors or minority shareholders under the oppression provisions of applicable corporate legislation. A guarantee could also be subject to challenge under provisions of applicable insolvency legislation dealing with transactions at under value or preference claims. Directors and officers would only be subject to personal liability in such cases if specific facts were pleaded to justify such a remedy (e.g. wrongdoing).

2.3 Is lack of corporate power an issue?

If the guarantor is a corporation, it must have the corporate power and capacity to give guarantees. Most business corporations have the powers and capacity of a natural person and it is unusual to see restrictions on the power to issue guarantees in the guarantor's constating documents. However, certain corporations created by statute for a public purpose (such as school boards) may still be subject to the doctrine of *ultra vires* and therefore may require express legislative authority to give guarantees.

2.4 Are any governmental or other consents or filings, or other formalities (such as shareholder approval), required?

Other than typical corporate authorising resolutions, no formal approvals are generally required. Where a corporation provides financial assistance by way of guarantee or otherwise, in some provinces the corporation is required to disclose the financial assistance to its shareholders after such assistance is given.

2.5 Are net worth, solvency or similar limitations imposed on the amount of a guarantee?

Not for corporations incorporated federally or under the laws of most provinces. However, the corporate laws in a few Atlantic Provinces and in two territories continue to prohibit financial assistance to members of an intercompany group if there are reasonable grounds to believe that the corporation would be unable to meet prescribed solvency tests after giving the assistance, subject to specific exceptions.

2.6 Are there any exchange control or similar obstacles to enforcement of a guarantee?

No; subject to the provisions of applicable Canadian federal money laundering and anti-terrorism legislation.

3 Collateral Security

3.1 What types of collateral are available to secure lending obligations?

Most types of personal property and real property are available to secure lending obligations, subject to certain limitations by contract (e.g. contractual restrictions on assignment) or by law (e.g. government receivables, permits, licences and quotas).

Provincial legislation generally governs the creation and enforcement of security. All Canadian provinces (except Québec) have adopted comprehensive personal property security acts (PPSAs) conceptually similar to Article 9 of the United States *Uniform Commercial Code* (UCC). The PPSAs govern the creation, perfection and enforcement of security interests in a debtor's personal property, and create a scheme for determining the priority of competing interests in the same collateral. The PPSAs apply to any transaction that in substance creates a security interest in personal property, regardless of the form of document used to grant the interest.

Québec, Canada's only civil law jurisdiction, has a European style Civil Code (the *Civil Code of Québec*) that governs the creation and enforcement of security on movable (personal) and immovable (real) property.

Certain types of property continue to be subject to additional federal registration and filing regimes (examples include intellectual property and assets in shipping, aircraft and railways). The federal *Bank Act* also has a special security regime available as an option available only to federally chartered banks for certain classes of debtors and collateral.

3.2 Is it possible to give asset security by means of a general security agreement or is an agreement required in relation to each type of asset? Briefly, what is the procedure?

A general security agreement (GSA) can be and often is used to grant security over all of the debtor's present and after-acquired personal property of every type and description. Separate agreements are not required for each type of asset. The GSA or other security agreement must contain a description of the collateral sufficient to enable it to be identified. However, a GSA typically does not extend to real property and separate requirements apply to registration and documentation of security against land, as described under question 3.3 below.

In most cases, the secured party perfects the security interest by registering a financing statement under the PPSA filing regime in the applicable province. Where the financing statement should be registered depends on the type of collateral. In general, security interests in most tangible personal property are registered in the province in which the collateral is located at the time of attachment. Security interests in most intangibles and certain types of goods normally used in more than one jurisdiction must be registered in the province in which the debtor is deemed to be located under the relevant debtor location rules. Except in Ontario, a debtor with multiple places of business is deemed to be located at its "chief executive office". Under amendments to Ontario's PPSA that came into force on December 31, 2015, most debtors are deemed to be located in the jurisdictions in which they were incorporated or organised, similar to the more generally applicable debtor location rules under Article 9 of the UCC.

The hypothec, Québec's only form of consensual security, may be granted by a debtor to secure any obligation, and may create a charge on existing and after-acquired movable (personal) or immovable (real) property, although there are certain additional formalities that must be met when taking security on immovable (real) property. It may be made with or without delivery, allowing the grantor of the hypothec to retain certain rights to use the property. In most cases, a hypothec must be published (registered) in Québec's Register of Personal and Movable Real Rights in accordance with applicable formalities in order to enable it to be set up against third parties (i.e., perfected).

3.3 Can collateral security be taken over real property (land), plant, machinery and equipment? Briefly, what is the procedure?

A lender may take collateral security over land or real property by way of a mortgage of the land, a mortgage of lease, a debenture, or, if the real property charged is in Québec, an immovable deed of hypothec. Interests in real property are registered in the land registry system of the relevant province. In Québec, the immovable hypothec is usually registered by a Québec notary in accordance with applicable formalities.

It should be noted that a higher rate of interest on amounts in arrears secured by a real property mortgage may be unenforceable under the *Interest Act* (Canada).

The procedure for taking security over plant, machinery and equipment that constitutes personal property under the PPSA or movables under the *Civil Code of Québec* is described in question 3.2 above.

Personal property may include "fixtures" (goods that become affixed to real property), but if the security interest has not attached prior to affixation, the creditors registered against the land gain priority, with limited exceptions. What constitutes a fixture is a factual question and the common law has taken a contextual approach. To protect the priority of its interest in a fixture, a secured party must both 1) perfect its security interest under the PPSA, and 2) register its interest in the land registry system. Under the *Civil Code of Québec*, the rules for determining what constitutes movable or immovable property are different – but the end results are comparable.

3.4 Can collateral security be taken over receivables? Briefly, what is the procedure? Are debtors required to be notified of the security?

Yes. The procedure for taking security over receivables is the same as described in question 3.2 above.

Notice to account debtors is not required to create a perfected security interest in accounts receivable under the PPSA. However, account debtors for the receivables are obligated to pay the receivable directly to the secured party only after receiving notice from the secured party that the receivable has been assigned to it. In addition, an absolute assignment of receivables constitutes a "security interest" regardless of whether it secures any obligations.

Under the *Civil Code of Québec*, if assigned receivables constitute a "universality of claims", the assignment must be registered for such assignment to be set up against third parties (i.e. perfected). However, account debtors must still be notified of such assignment before an account debtor is obligated to pay the receivable directly to the secured party. If the receivables do not constitute a universality of claims, the assignment may be perfected with respect to Québec obligors only by actual notice of the assignment to such obligors.

Under Canadian federal legislation, subject to prescribed exceptions, receivables owed by the federal government can be assigned only absolutely (not as security) and only with appropriate notice to the appropriate official of the government of Canada, which must be acknowledged. Some provinces have similar legislation covering receivables owed by the provincial government. In Canada, asset-based lenders frequently exclude government receivables from the borrowing base.

3.5 Can collateral security be taken over cash deposited in bank accounts? Briefly, what is the procedure?

The PPSA and *Civil Code of Québec* permit a lender to take security over deposit accounts. Under the PPSA, deposits in bank accounts are treated as "accounts" or receivables owed by the depository bank to the depositor and under the *Civil Code of Québec* as claims against the bank. Accordingly, in PPSA jurisdictions, security interests in deposit accounts are perfected by registering a financing statement in the province where the debtor is deemed to be located under the applicable debtor location rules (see question 3.2 above). Traditionally, a bank lender that maintained deposit accounts for its debtor and wished to take security in such accounts would do so by way of set off and a "flawed asset" approach. However, in light of a Supreme Court of Canada case that poses a risk of recharacterisation, the lender should also register a PPSA financing statement against the debtor.

No PPSA jurisdiction has yet adopted control as a means of perfecting security interests in deposit accounts. However, as of January 1, 2016, certain amendments to the *Civil Code of Québec* came into force whereby it became possible to perfect hypothecs over cash deposits in bank accounts (referred to as monetary claims) by "control". Where the creditor is also the account bank, the creditor obtains control by the debtor (i.e. the account holder) consenting to such monetary claims securing performance of its obligations to the creditor. Where the creditor is not the account bank, the creditor obtains control by either: (i) entering into a control agreement with the account bank and the debtor, pursuant to which the account bank agrees to comply with the creditor's instructions, without the additional consent of the debtor; or (ii) becoming the account holder.

3.6 Can collateral security be taken over shares in companies incorporated in your jurisdiction? Are the shares in certificated form? Can such security validly be granted under a New York or English law governed document? Briefly, what is the procedure?

A security interest in shares issued by companies incorporated in any jurisdiction is typically documented by way of a standalone pledge agreement or included in a general security agreement. While the jurisdiction governing validity, perfection or non-perfection of the pledge will be determined under applicable conflict of laws rules, the security interest may be granted under a document governed by New York or English law, subject to the principles discussed in question 7.1 below.

Under the PPSA and the *Securities Transfer Act, 2006* (STA), versions of which are in force in all but one Canadian PPSA jurisdiction (harmonised legislation is in force in Québec), a secured party can perfect its security interest in shares by registering under the PPSA or by taking control under the STA (or both). An interest perfected by control has priority over one perfected only by registration or simple delivery of the unendorsed share certificates.

Shares may be either certificated or uncertificated. For certificated shares, taking physical possession of the share certificates, together with a suitable endorsement (which can be on a separate instrument such as a stock power of attorney), meets the STA requirement for control. For uncertificated shares, control is obtained by being registered as the shareholder or through a control agreement with the issuer. Control over securities held indirectly through securities accounts can be achieved by other means (for example, a control agreement with the relevant intermediary).

It should also be noted that under securities legislation, a private company's constating documents must include a restriction on the right to transfer its shares. This restriction usually states that each transfer of the company's shares requires approval by the company's directors or shareholders.

3.7 Can security be taken over inventory? Briefly, what is the procedure?

Yes. The procedure is generally the same as described in question 3.2.

The security interest may be perfected by registering a financing statement in the province or territory in which the inventory is situated at the time the security interest attaches, except that inventory of a type normally used in more than one jurisdiction that is leased or held for lease by the debtor to others requires registration in the province in which the debtor is deemed to be located.

The purchase of inventory is often financed by way of a purchase money security interest (or PMSI). A PMSI in collateral is, in substance, a security interest given by either the seller or a third party to finance the purchase of the collateral by the debtor. The PPSA provides that a PMSI in inventory and other types of collateral (other than investment property or its proceeds) have priority over any other security interest in the same collateral given by the same debtor (even if that other security interest was registered first) so long as certain timing and (and, in the case of inventory) third-party notice requirements are satisfied. The *Civil Code of Québec* does not offer a comparable approach and subordination or cession of rank is required from any prior ranking secured creditor.

3.8 Can a company grant a security interest in order to secure its obligations (i) as a borrower under a credit facility, and (ii) as a guarantor of the obligations of other borrowers and/or guarantors of obligations under a credit facility (see below for questions relating to the giving of guarantees and financial assistance)?

Yes, it can.

3.9 What are the notarisation, registration, stamp duty and other fees (whether related to property value or otherwise) in relation to security over different types of assets?

Registration fees are payable in connection with the filing of PPSA financing statements, increasing with the length of the registration period. These are relatively modest – for example, in Ontario it is $8.00 for each year of the registration period or $500 for a perpetual registration.

A modest tax is payable upon registering real property security in certain Canadian jurisdictions. The tax is based on a fee and where the face amount of the registration exceeds the value of the lands, one is permitted to pay on the basis of a percentage of the property value.

No Canadian jurisdiction imposes stamp taxes or duties in relation to security. In Québec, if a notarial deed of hypothec is used, the notary will generally charge a fee for execution, keeping it in its notarial records and for issuing copies; however, there is no additional material cost.

3.10 Do the filing, notification or registration requirements in relation to security over different types of assets involve a significant amount of time or expense?

The registration requirements in most cases are relatively straightforward and inexpensive. As noted above in question 3.7, a PMSI in inventory requires prior notice to certain secured parties in order to ensure priority.

3.11 Are any regulatory or similar consents required with respect to the creation of security?

For certain special types of regulated property, consents or approvals may be required by governmental authorities or agencies for both the creation and enforcement of security. Governmental licences, permits and quotas are subject to specific regimes requiring notice or consent in many cases. See question 3.4 regarding government receivables.

3.12 If the borrowings to be secured are under a revolving credit facility, are there any special priority or other concerns?

A security interest and hypothec in personal property or movable property may secure both present and future advances under a revolving credit facility. Where future advances are made while a security interest is perfected, the security interest has the same priority with respect to each future advance as it has with respect to the first advance, with certain limited exceptions in favour of unsecured execution and other creditors that seize the collateral if the secured party makes the advance after receiving notice of their interests. A security interest in personal property is not automatically discharged by reason of the fact that the outstanding balance under a revolving line of credit has been paid down to zero and subsequently re-advanced.

Generally, advances on a real property mortgage made without actual notice of a subsequent claim will typically have priority over such subsequent claims and, accordingly, mortgages securing revolving credit normally provide that subsequent liens are prohibited. Certain priority exceptions apply such as in respect of construction liens. Real property mortgages securing revolving credit should be properly worded to address situations where the borrowing is fully or partially repaid and thereafter re-advanced.

3.13 Are there particular documentary or execution requirements (notarisation, execution under power of attorney, counterparts, deeds)?

In Québec, security over immovable property or in favour of a collateral agent on behalf of multiple secured parties (referred to as “hypothecary representative”) requires execution of the deed of hypothec before an authorised Québec notary.

Each province has different requirements with respect to real property, including specific registration forms, evidence of corporate authority, affidavits and, in some jurisdictions, originals for registration.

4 Financial Assistance

4.1 Are there prohibitions or restrictions on the ability of a company to guarantee and/or give security to support borrowings incurred to finance or refinance the direct or indirect acquisition of: (a) shares of the company; (b) shares of any company which directly or indirectly owns shares in the company; or (c) shares in a sister subsidiary?

Most Canadian corporations are not subject to such restrictions, except those created under the laws of a few Atlantic Provinces (New Brunswick, Prince Edward Island and Newfoundland) and certain territories (the Northwest Territories and Nunavut). Certain provinces (Alberta, British Columbia, Ontario and Saskatchewan) require that financial assistance be disclosed to shareholders, but failure to disclose does not invalidate the transaction.

5 Syndicated Lending/Agency/Trustee/Transfers

5.1 Will your jurisdiction recognise the role of an agent or trustee and allow the agent or trustee (rather than each lender acting separately) to enforce the loan documentation and collateral security and to apply the proceeds from the collateral to the claims of all the lenders?

Yes. The agency concept is recognised in Canadian common law and agents are commonly used in syndicated lending for both administration of loans and holding collateral security in Canada. Indenture trustees are typically used in public bond transactions.

5.2 If an agent or trustee is not recognised in your jurisdiction, is an alternative mechanism available to achieve the effect referred to above which would allow one party to enforce claims on behalf of all the lenders so that individual lenders do not need to enforce their security separately?

For purposes of holding collateral security in the province of Québec, the mechanism commonly used requires the appointment of the collateral agent as a "hypothecary representative", together with a notarial deed of hypothec in favour of such hypothecary representative.

5.3 Assume a loan is made to a company organised under the laws of your jurisdiction and guaranteed by a guarantor organised under the laws of your jurisdiction. If such loan is transferred by Lender A to Lender B, are there any special requirements necessary to make the loan and guarantee enforceable by Lender B?

Assignments of debt, guarantees and security can be effected by contract pursuant to a standard assignment and assumption agreement. Where the assignor is also the secured party of record (whether as collateral agent or otherwise), PPSA financing statements (and the Québec equivalent) are typically amended to record the assignment, although such amendments are not required for enforceability (except in Québec). Mortgage or security assignments are required to be filed under the applicable land registry to give effect to the assignment. In the case of Québec, where the security is in favour of the hypothecary representative and there is a substitution of hypothecary representative (as a result of the assignment or otherwise), the new hypothecary representative cannot exercise recourse under the hypothec until such substitution is registered where applicable.

6 Withholding, Stamp and Other Taxes; Notarial and Other Costs

6.1 Are there any requirements to deduct or withhold tax from (a) interest payable on loans made to domestic or foreign lenders, or (b) the proceeds of a claim under a guarantee or the proceeds of enforcing security?

There are generally no requirements to deduct or withhold tax on payments of interest by a debtor or guarantor (whether by voluntary payment, enforcement or otherwise) made by a domestic debtor or guarantor to domestic lenders.

Conventional interest payments made to arm's-length lenders that are non-residents of Canada are generally not subject to Canadian withholding tax, regardless of their country of residence. In addition, conventional interest payments made to certain non-arm's length US resident lenders may qualify for an exemption from Canadian withholding tax under the Canada-US Tax Treaty.

Certain interest payments made in respect of back-to-back loans, including loans between related parties, which are channelled through an independent third-party intermediary, may be subject to Canadian withholding tax.

In the absence of any applicable exemption under a bilateral tax treaty or under the *Income Tax Act* (Canada), withholding tax on interest payments may apply at rates of up to 25%.

6.2 What tax incentives or other incentives are provided preferentially to foreign lenders? What taxes apply to foreign lenders with respect to their loans, mortgages or other security documents, either for the purposes of effectiveness or registration?

Generally, there are no material tax or other incentives provided preferentially to foreign investors or creditors and no taxes apply to security documents for the purposes of effectiveness or registration.

6.3 Will any income of a foreign lender become taxable in your jurisdiction solely because of a loan to, or guarantee and/or grant of, security from a company in your jurisdiction?

While each lender's tax position must be examined individually, generally a non-resident lender's income should not be taxable in Canada solely because of a single secured loan transaction in the absence of a fixed presence in Canada or other connecting factors.

6.4 Will there be any other significant costs which would be incurred by foreign lenders in the grant of such loan/guarantee/security, such as notarial fees, etc.?

(See question 3.9 for a discussion of the relevant filing and notarial fees.) There are no stamp taxes, registration taxes or documentary taxes that are generally applicable in connection with authorisation, delivery or performance of loans, guarantees or security.

6.5 Are there any adverse consequences for a company that is a borrower (such as under thin capitalisation principles) if some or all of the lenders are organised under the laws of a jurisdiction other than your own? Please disregard withholding tax concerns for purposes of this question.

Thin capitalisation rules under the *Income Tax Act* (Canada) determine whether a Canadian corporation may deduct interest on the amount borrowed from a "specified non-resident shareholder" of the corporation or from a non-resident person who does not deal at arm's length with a "specified shareholder" (collectively "specified non-residents"). A "specified shareholder" of a corporation is, in general terms, a person who, either alone or together with persons with whom they do not deal at arm's length, owns 25% or more of the voting shares, or owns 25% or more of the fair market value of the issued and outstanding shares of the corporation.

Under the thin capitalisation rules, Canadian corporations are effectively prevented from deducting interest arising in respect of the portion of loans from specified non-residents that exceeds one-and-a-half times the corporation's specified equity (in highly simplified terms, retained earnings, share capital and contributed surplus attributable to specified non-residents). In addition, any interest expenses that are disallowed under these rules are deemed to be dividends paid to the lender for non-resident withholding tax purposes, and subject to withholding tax.

In addition, the thin capitalisation rules may apply in respect of interest paid or payable on back-to-back loans. However, most traditional forms of commercial collateralisation or guarantees should not attract the application of these rules, especially where any loans made by the third party are clearly made from the third party's own sources.

The thin capitalisation rules also apply (with appropriate modifications) to (i) Canadian resident trusts, (ii) non-resident corporations or trusts that carry on business in Canada (in respect of loans that are used in the course of that Canadian business), and (iii) partnerships in which a Canadian resident corporation or trust or a non-resident corporation or trust is a member.

7 Judicial Enforcement

7.1 Will the courts in your jurisdiction recognise a governing law in a contract that is the law of another jurisdiction (a "foreign governing law")? Will courts in your jurisdiction enforce a contract that has a foreign governing law?

Subject to certain exceptions and conditions, Canadian courts will recognise and apply the parties' choice of governing law if it is specifically pleaded and proven by expert testimony.

Canadian courts will not apply the foreign law if the choice of law is not *bona fide* or is contrary to public policy, or if so doing would be considered enforcement of foreign revenue, or expropriatory or penal law. Additionally, Canadian courts will apply Canadian procedural law and certain provincial and federal laws that have overriding effect, such as bankruptcy and insolvency statutes, federal crime legislation, employment legislation and consumer protection legislation.

7.2 Will the courts in your jurisdiction recognise and enforce a judgment given against a company in New York courts or English courts (a "foreign judgment") without re-examination of the merits of the case?

A foreign monetary judgment may be enforced in Canada if the judgment is final and the foreign court properly assumed jurisdiction. As long as these requirements are met, a Canadian court will not examine whether the foreign court correctly applied its own substantive and procedural laws.

In considering the issue of jurisdiction, Canadian courts will apply their own principles of jurisdiction. Generally a contractual submission to the jurisdiction of the foreign court will be sufficient, but in the absence of such submission, the Canadian court will examine whether there was a "real and substantial connection" between the foreign court and the cause of action or the defendant. While the test is often applied generously and flexibly by the courts, a fleeting or relatively unimportant connection will not support a foreign court's assumption of jurisdiction.

There are certain limited defences which preclude recognition related to circumstances under which the foreign judgment was obtained (such as by fraud or in a manner breaching principles of natural justice) and whether there is any reason it would be improper or contrary to public policy to recognise the foreign judgment. In practice, these defences rarely succeed.

7.3 Assuming a company is in payment default under a loan agreement or a guarantee agreement and has no legal defence to payment, approximately how long would it take for a foreign lender to (a) assuming the answer to question 7.1 is yes, file a suit against the company in a court in your jurisdiction, obtain a judgment, and enforce the judgment against the assets of the company, and (b) assuming the answer to question 7.2 is yes, enforce a foreign judgment in a court in your jurisdiction against the assets of the company?

(a) In Ontario, if no defence is filed in response to a claim, default judgment may be obtained between 20 and 60 days after the claim has been served on the defendant, depending on where service is effected. After any judgment is obtained, and subject to it being stayed by the filing of a notice of appeal, enforcement proceedings may be commenced immediately.

(b) An application hearing to enforce a foreign judgment in Ontario may generally be obtained within approximately two to three months.

Procedural and substantive law differs by province, but the timing described above is similar in most other provinces.

7.4 With respect to enforcing collateral security, are there any significant restrictions which may impact the timing and value of enforcement, such as (a) a requirement for a public auction, or (b) regulatory consents?

A secured creditor must give the debtor reasonable time to pay following demand, before taking action to enforce against its collateral security (even if the debtor purported to waive these rights).

Where a secured creditor intends to enforce security over substantially all of an insolvent debtor's inventory, accounts receivable or other property used in relation to the debtor's business, in addition to delivering a demand, the secured creditor must also deliver a notice of intention to enforce security in the form prescribed under the *Bankruptcy and Insolvency Act* (BIA) at least 10 days before such enforcement, unless the debtor consents to an earlier enforcement. A slightly longer notice period may be required if collateral is located in the Province of Québec.

If a secured creditor intends to deal with the collateral itself or through a privately appointed receiver (where applicable), it must also give advance notice to the debtor and other interested parties of its intention to dispose of the collateral or accept the collateral as final settlement of the debtor's obligations. This notice period is typically 15–20 days depending on the applicable PPSA and can run concurrently with the BIA enforcement notice.

Although there is no requirement for a public auction, a secured creditor (and any receiver) must act in good faith and in a commercially reasonable manner when selling or otherwise disposing of the collateral. However, if a lender wishes to buy the collateral, it may only do so at a public sale, unless otherwise permitted by a court. Generally speaking, no regulatory consents are required to enforce on collateral security.

7.5 Do restrictions apply to foreign lenders in the event of (a) filing suit against a company in your jurisdiction, or (b) foreclosure on collateral security?

To maintain an action in certain provinces, foreign lenders may be required to become extra-provincially registered.

There are no specific restrictions on a foreign lender's ability to enforce security in Canada. However, if the lender chooses to exercise those remedies to either foreclose on the collateral security or to credit-bid its debt, such that the foreign lender ends up owning the debtor's Canadian assets, the foreign lender may be subject to restrictions imposed by the *Investment Canada Act* or the *Competition Act*.

7.6 Do the bankruptcy, reorganisation or similar laws in your jurisdiction provide for any kind of moratorium on enforcement of lender claims? If so, does the moratorium apply to the enforcement of collateral security?

Yes, a stay of proceedings may affect the rights of secured and unsecured creditors in some circumstances to the extent set out in question 8.1.

7.7 Will the courts in your jurisdiction recognise and enforce an arbitral award given against the company without re-examination of the merits?

Provincial arbitration acts provide for the enforcement of arbitral awards by application to the court. Canadian courts will not re-examine the merits of an arbitral award; however the award may be set aside on specified grounds including, but not limited to, an invalid arbitration agreement, an award outside of the jurisdiction of the arbitrator, or a reasonable apprehension of bias on the part of the arbitrator.

The Convention on the Recognition and Enforcement of Foreign Arbitral Awards and the *UNCITRAL Model Law on International Commercial Arbitration* have been adopted in all Canadian provinces and provide rules for the enforcement of international arbitral awards. Subject to limited grounds on which enforcement of an international arbitral award may be refused, the awards are generally enforceable in Canada.

8 Bankruptcy Proceedings

8.1 How does a bankruptcy proceeding in respect of a company affect the ability of a lender to enforce its rights as a secured party over the collateral security?

Bankruptcy and insolvency in Canada are primarily governed by two federal statutes: the BIA; and the *Companies' Creditors Arrangement Act* (CCAA). The BIA provides a comprehensive liquidation scheme for companies and individuals, along with a streamlined reorganisation regime. The CCAA is Canada's large company reorganisation statute. Although some aspects of creditors' rights are determined by provincial statutes, bankruptcy and insolvency law is mostly uniform across Canada. Insolvency proceedings under the BIA or CCAA will result in the imposition of a stay of proceedings either by a Canadian court or pursuant to the relevant statute.

Under the BIA liquidation proceedings, the automatic stay of proceedings imposed upon commencement will not prevent a secured creditor from realising or otherwise dealing with its collateral. By contrast, in a court-appointed receivership (an alternative form of liquidation proceeding governed by the BIA), receivership orders routinely contain language staying the actions of secured creditors.

If a debtor files a notice of intention to make a proposal (NOI) or a proposal to creditors under the BIA (a reorganisation proceeding), a secured creditor's enforcement rights will be automatically stayed during the reorganisation proceeding, unless: (i) the secured creditor took possession of the collateral before the filing; (ii) the secured creditor delivered its BIA enforcement notice more than 10 days prior to the filing of the NOI; or (iii) the debtor consents to the secured creditor exercising its enforcement rights.

Reorganisation proceedings under the CCAA are commenced when an initial order is granted by the court. The CCAA explicitly empowers a court to grant a stay of proceedings against the debtor on any terms that it may impose. The stay provision in the CCAA initial order typically prohibits secured creditors from enforcing their security interests against the debtor's property during the proceeding.

8.2 Are there any preference periods, clawback rights or other preferential creditors' rights (e.g., tax debts, employees' claims) with respect to the security?

(a) Avoidance actions

Under the BIA and the CCAA, certain transactions, including the granting of security, the transfer of property and other obligations are voidable if incurred during specified pre-bankruptcy time periods. Subject to certain conditions and exemptions, if such transactions are made with a view to giving one creditor a preference over others, they may be set aside if entered into during the period that is: (i) three months before the initial bankruptcy event for transactions at arm's length; and (ii) one year before the initial bankruptcy event for transactions not at arm's length.

Transfers of property (or services sold), in which the consideration the debtor receives is less than the fair market value, subject to certain other conditions and exemptions, may be set aside under the BIA or CCAA if entered into during the period that is (i) one year before the initial bankruptcy event for transactions at arm's length, and (ii) five years before the initial bankruptcy event for transactions not at arm's length.

There is also provincial legislation providing for setting aside other fraudulent conveyances or preferential transactions.

(b) Statutory priority claims

In Canada, a number of statutory claims may "prime" or take priority over a secured creditor. Priming liens commonly arise from a debtor's obligation to remit amounts collected or withheld on behalf of the government. Such amounts include unremitted employee deductions for income tax, government pension plan contributions, government employment insurance premiums and unremitted federal goods and services taxes, provincial sales taxes, municipal taxes and workers' compensation assessments. In Ontario, statutory deemed trusts may give rise to a priority claim for certain unpaid claims of employees, including, in some circumstances, a deemed trust arising upon wind-up of a defined benefit pension plan for any deficiency amounts. In addition, there are a number of statutes that create priming liens in specific industries (for example, repair and storage liens, construction liens and brokerage liens). These priming liens may attach to all of the property of the debtor. In some cases, the priority of statutory claimants and secured creditors is sometimes reversed by the commencement of an insolvency proceeding against the debtor.

(c) Priority claims – insolvency

An insolvency proceeding in respect of the debtor may give rise to a number of additional liens that would rank in priority to a secured creditor's claims.

The BIA provides employees of a bankrupt employer or an employer in receivership with a priority charge on the employer's "current assets" for unpaid wages and vacation pay (but not for severance or termination pay) for the six-month period prior to bankruptcy or receivership to a maximum of $2,000 per employee (plus up to $1,000 for certain travelling expenses). The priority charge ranks ahead of all other claims, including secured claims, except unpaid supplier rights.

The BIA also grants a priority charge in bankruptcies and receiverships for outstanding current service pension plan contributions, subject only to the wage earners' priority. The pension contribution priority extends to all assets, not just current assets, and is unlimited in amount.

The pension charge secures (i) amounts deducted as pension contributions from employee wages but not contributed to the plan prior to a bankruptcy or receivership, and (ii) amounts required to be contributed by the employer to a pension plan for "normal costs". The charge does not extend to unfunded deficits arising upon a wind-up of a defined benefit plan and should not include scheduled catch-up or special payments required to be made by an employer because of the existence of a solvency deficiency.

The CCAA and the reorganisation provisions of the BIA expressly prohibit a court from sanctioning a proposal, compromise or arrangement or a sale of assets, unless it is satisfied that the debtor has arranged to pay an amount equal to the amounts secured by the wage and pension priority charges discussed above.

(d) Priority claims – court charges

In CCAA and BIA reorganisations, debtors may obtain interim financing (often referred to as debtor in possession (DIP) financing). Both the CCAA and the BIA expressly authorise the court to grant fresh security over a debtor's assets to DIP lenders in priority to existing security interests up to a specified amount approved by the court.

In addition to the priming liens noted above, in a CCAA or BIA reorganisation, the court has the authority to order priming charges to secure payment of directors' post-filing liabilities and to secure the fees and disbursements of experts, court-appointed officials and certain other "interested parties" in the court's discretion. The court may also order priming charges to secure payment to designated "critical suppliers", typically restricted to securing payment for post-filing supply.

The priority of the DIP charge, directors' charge, expense charge and any critical supplier charge in respect of the debtor's assets is determined by the court.

(e) Unpaid suppliers' rights

The BIA provides certain unpaid suppliers with a right to repossess goods sold and delivered to a purchaser within 30 days before the date of bankruptcy or receivership of such purchaser. The unpaid supplier's right to repossess goods effectively ranks ahead of a secured creditor.

An unpaid supplier claim is rarely successful as the supplier has the burden of demonstrating that all requirements have been met, including: (i) that the debtor has possession of the goods; (ii) that the goods are identifiable; (iii) that the goods are in the same state; and (iv) that the goods have not yet been sold.

8.3 Are there any entities that are excluded from bankruptcy proceedings and, if so, what is the applicable legislation?

Banks (including the Canadian business of foreign banks authorised to do business in Canada), insurance companies and trust corporations are excluded from the BIA and CCAA and their wind up is governed by the *Winding-Up and Restructuring Act* (Canada). The BIA and CCAA also exclude railway and telegraph companies. However, in a recent case a court granted a railway company relief under the CCAA.

8.4 Are there any processes other than court proceedings that are available to a creditor to seize the assets of a company in an enforcement?

Upon default, a secured creditor may exercise "self-help" remedies to take possession and control of collateral individually or through the appointment of a private receiver (if provided in its security documents). Secured creditors may also seek court appointment of an interim receiver to preserve and protect collateral on an expedited basis.

9 Jurisdiction and Waiver of Immunity

9.1 Is a party's submission to a foreign jurisdiction legally binding and enforceable under the laws of your jurisdiction?

The submission by a party to the non-exclusive jurisdiction of the courts of a foreign jurisdiction should be recognised as valid, provided that service of process requirements are complied with. The submission by a party to the exclusive jurisdiction of the courts of a foreign jurisdiction is generally recognised unless there is "strong cause" not to do so.

9.2 Is a party's waiver of sovereign immunity legally binding and enforceable under the laws of your jurisdiction?

The *State Immunity Act* (Canada) governs sovereign immunity of foreign states and any separate agency of a foreign state (e.g. state trading corporations). Private corporations that are not "organs" of a foreign state are not entitled to sovereign immunity.

Sovereign immunity may be waived if the state or agency submits to the jurisdiction of the Canadian court by agreement, either before or after commencement of the proceedings. Sovereign immunity is subject to certain exceptions (e.g. commercial activities and property damage actions, terrorist activities and certain maritime claims).

10 Licensing

10.1 What are the licensing and other eligibility requirements in your jurisdiction for lenders to a company in your jurisdiction, if any? Are these licensing and eligibility requirements different for a "foreign" lender (i.e. a lender that is not located in your jurisdiction)? In connection with any such requirements, is a distinction made under the laws of your jurisdiction between a lender that is a bank *versus* a lender that is a non-bank? If there are such requirements in your jurisdiction, what are the consequences for a lender that has not satisfied such requirements but has nonetheless made a loan to a company in your jurisdiction? What are the licensing and other eligibility requirements in your jurisdiction for an agent under a syndicated facility for lenders to a company in your jurisdiction?

There are no specific eligibility requirements for lenders solely as a result of entering into a secured lending transaction as lender or agent.

Under the *Bank Act* (Canada), a "foreign bank" is generally not permitted to engage in or carry on business in Canada except through a foreign bank subsidiary, an authorised foreign branch or other approved entity. A "foreign bank" is broadly defined in the Act and includes any foreign entity that (i) is a bank under the laws of a foreign country in which it carries on business or carries on business in a foreign country which would be considered the business of banking, (ii) provides financial services and uses the word "bank" in its name, (iii) is in the business of lending money and accepting deposit liabilities transferable by cheque or other instrument, (iv) provides financial services and is affiliated with a foreign bank, or (v) controls a foreign bank or a Canadian bank.

However, the *Bank Act* would not prohibit a foreign bank from making a loan to a Canadian borrower as long as the nature and extent of its activities in Canada do not amount to engaging in or carrying on business in Canada. Whether a foreign bank would be considered to be engaging in or carrying on business in Canada by reason of making a particular loan to a Canadian borrower will depend on the relevant facts and circumstances.

A non-bank lender may be required to obtain an extra-provincial licence in each province in which it is considered to be carrying on business under provincial corporate law. Such determination may vary somewhat in each province; however, similar factors to those above will be relevant. A corporation which owns or leases real property in, or has an employee or agent that is resident in, such province will generally be considered to be carrying on business in that province.

In the case of either a bank or non-bank lender, a loan transaction involving a Canadian borrower would not be void or voidable by reason of such lender's failure to comply with applicable regulatory requirements in Canada.

11 Other Matters

11.1 Are there any other material considerations which should be taken into account by lenders when participating in financings in your jurisdiction?

The *Criminal Code* (Canada) makes it a criminal offence to receive interest at a criminal rate, defined as an effective annual rate of interest that exceeds 60%. Interest in the *Criminal Code* (Canada) is broadly defined to include interest, fees, fines, penalties, commission and similar charges and expenses that a borrower pays in connection with the credit advanced. This section has been considered almost exclusively in civil (not criminal) cases where the borrower seeks to avoid repayment by arguing that the contract was illegal. Courts have struggled with deciding which, if any, contractual provisions should be enforced when a contract imposes a criminal rate of interest.

Note

Please note that the answers in this chapter are up to date as of December 11, 2018. Readers are cautioned against making decisions based on this material alone. Rather, any proposal to do business in Canada should be discussed with qualified professional advisors.

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Cayman Islands

Maples Group

Tina Meigh

1 Overview

1.1 What are the main trends/significant developments in the lending markets in your jurisdiction?

The Cayman Islands continues to be a jurisdiction of choice for the establishment of investment funds, portfolio investment companies and corporate vehicles, each of which utilise secured lending arrangements in a variety of forms. We continue to see an increase in the use of hybrid and NAV facilities in both the private equity and hedge fund space. We have also seen a significant increase in the use of financings utilising investment fund holding entities structured as orphan vehicles to address US bankruptcy concerns of lenders. Exempted companies and exempted limited partnerships are still the most popular entities across all business areas, but we have also seen a significant rise in the use of the new limited liability company which has gained significant traction in the financing space as a result of advantageous hybrid features taken from both the company and exempted limited partnership regimes.

The Cayman Islands continues to be a creditor-friendly jurisdiction and favoured by many lending houses and financial institutions for all fund financing and secured lending transactions.

1.2 What are some significant lending transactions that have taken place in your jurisdiction in recent years?

The most significant lending transactions continue to occur in the investment funds space, especially to Cayman Islands domiciled private equity funds. These transactions tend to be governed by New York and English law finance documents with security taken over Cayman Islands assets being governed by both Cayman Islands law and non-Cayman Islands law. Although the courts in the Cayman Islands generally recognise foreign law documents, lenders often prefer, for commercial purposes, to have dual Cayman Islands law governed security.

The main types of security are, in the case of funds established in the form of exempted limited partnerships, exempted companies and limited liability companies, security over capital calls (the right to call such capital and the right to receive the proceeds of such calls) and, more generally, security over Cayman Islands equity interests, either in the form of registered shares or exempted limited partnership interests. This is particularly common where there is a "master-feeder" structure or underlying blocker entities are used to hold assets and those structures are looking to utilise subscription and hybrid facilities.

2 Guarantees

2.1 Can a company guarantee borrowings of one or more other members of its corporate group (see below for questions relating to fraudulent transfer/financial assistance)?

Yes, a company can grant a guarantee in these circumstances assuming there is sufficient commercial rationale and benefit to the company.

2.2 Are there enforceability or other concerns (such as director liability) if only a disproportionately small (or no) benefit to the guaranteeing/securing company can be shown?

The directors of the company providing a guarantee must ensure that any proposed transaction is in the best interests of the company as a whole. Guarantee arrangements may be construed as not being in the best interests of a company (and not for the company's corporate benefit) if the granting company receives no commercial benefit from the underlying financing arrangements.

The directors of the company giving the guarantee should approve the terms and execution of the guarantee by way of board resolution in accordance with the company's articles of association. If there is any question of lack of corporate benefit or a potential breach of director's duties, it is recommended that the company also obtain a shareholders' resolution approving the grant of the guarantee.

2.3 Is lack of corporate power an issue?

In accordance with the Companies Law (2018 Revision), the lack of capacity of a company to enter into a transaction by reason of anything in the company's memorandum will not affect the validity of the transaction. However, where the company is acting without the necessary capacity, shareholders may issue proceedings prohibiting the company from performing its obligations under the transaction (including disposing of any property) and proceedings may be brought against present and past directors or officers of the company for loss or damage caused by them binding the company in this manner contrary to the objects in the memorandum.

If a shareholder brings proceedings to restrict the company from performing its obligations, we believe such action would not affect the other party's rights under the transaction. If the company fails to perform, the other party would have the usual remedies.

2.4 Are any governmental or other consents or filings, or other formalities (such as shareholder approval), required?

Subject to any licensing restrictions that may apply to a regulated entity, no authorisations or consents are required by law from any governmental authorities or agencies or other official bodies in the Cayman Islands in connection with the grant of a guarantee. In addition, it is not necessary to ensure the enforceability or admissibility in evidence of a guarantee that any document be filed, recorded or enrolled with any governmental authority or agency or any official body in the Cayman Islands.

The directors of the company giving the guarantee should approve the terms and execution of the guarantee by way of board resolution in accordance with the company's articles of association. If there is any question of lack of corporate benefit or a potential breach of director's duties, it is recommended that the company also obtain a shareholders' resolution also approving the grant of the guarantee.

2.5 Are net worth, solvency or similar limitations imposed on the amount of a guarantee?

There are no legislative restrictions imposed on the amount of any guarantee due to net worth or the solvency of a company. However, the directors of a company should, as part of fulfilling their fiduciary duties, consider the terms of any guarantee, particularly in the context of the company's asset base.

2.6 Are there any exchange control or similar obstacles to enforcement of a guarantee?

There are no exchange control regulations imposed under Cayman Islands law that would act as an obstacle to enforcement of a guarantee.

3 Collateral Security

3.1 What types of collateral are available to secure lending obligations?

There are no legislative restrictions on the form of collateral and, accordingly, all property of a company is potentially available as security for lending obligations.

3.2 Is it possible to give asset security by means of a general security agreement or is an agreement required in relation to each type of asset? Briefly, what is the procedure?

It is possible for security to be taken by means of a general security agreement, such as a debenture, over a range of asset types. The main types of security under Cayman Islands law are mortgages (legal and equitable), charges (fixed and floating), liens and assignments of rights by way of security (albeit that this is deemed to be a form of mortgage). Formalities and perfection of such security interests will depend upon the nature of the underlying collateral and the applicable *lex situs* of such collateral.

Special regimes apply to the taking of security over certain assets, including ships, aircraft and land.

3.3 Can collateral security be taken over real property (land), plant, machinery and equipment? Briefly, what is the procedure?

Security over land is usually granted by way of legal or equitable mortgage and by way of fixed charge over plant, machinery and equipment. In relation to chattels, security can also be created by a conditional bill of sale which must be recorded in accordance with the Bills of Sale Law (2016 Revision).

A legal mortgage is granted by execution of a mortgage agreement between the mortgagor and the secured creditor. The terms of the mortgage will vary, but essentially a mortgage (i) requires transfer of legal title in the land to the secured creditor, subject to a requirement to re-transfer the land upon satisfaction of the underlying secured obligations, and (ii) grants the secured creditor certain powers to deal with the land upon a default.

An equitable mortgage can be created by (i) the execution of an equitable mortgage, (ii) an agreement to create a legal mortgage, (iii) a transfer of land which is not perfected by registering the secured creditor in the Land Registry in accordance with the Registered Lands Law, and (iv) the deposit of the relevant title deeds by way of security.

Fixed and floating charges are usually evidenced by an agreement between the parties reflecting the grant of the security interest and setting out the commercial terms.

A company must make an entry in its register of mortgages and charges in respect of any security interest created by it in order to comply with section 54 of the Companies Law (2018 Revision). An LLC must make an entry on its register of mortgages and charges in a similar manner to an exempted company incorporated or referenced under the Companies Law, in accordance with Section 62(1) of the LLC Law. However, failure to comply with these requirements does not invalidate the security interests created by either a company or LLC.

3.4 Can collateral security be taken over receivables? Briefly, what is the procedure? Are debtors required to be notified of the security?

Receivables arising under contract are examples of "choses in action", being a right which can only be asserted by bringing an action and not by taking possession of a physical thing. Receivables can be mortgaged or charged where that mortgage or charge takes the form of an assignment with an express or implied provision for reassignment on redemption. If a chose in action is charged, the charge can be either fixed or floating.

An assignment can be either legal or equitable, depending on the circumstances. The key requirements of a legal assignment are that it is: (i) an absolute assignment of the whole of a present (not future) chose in action; and (ii) the assignment must be both in writing and signed by the assignor and notified in writing to the debtor. An equitable assignment generally only relates to part of a chose in action and/or does not involve the notification of the debtor.

A company and LLC must make an entry in its register of mortgages and charges in respect of any security interest created by it. See question 3.3 above.

3.5 Can collateral security be taken over cash deposited in bank accounts? Briefly, what is the procedure?

A security interest over cash deposits is most commonly created by either a fixed or floating charge, depending on the commercial intention of the parties and the level of control maintained over such cash deposits. The secured creditor should ensure that there is an agreement (usually a deed). Cash deposits are classified as choses in action. Accordingly, the analysis in question 3.4 above applies.

In accordance with Cayman Islands conflict of law rules, the appropriate law to govern any security over cash deposited with a bank will be the law applicable where the bank is located (or the location of the bank branch with which the deposit is made).

3.6 Can collateral security be taken over shares in companies incorporated in your jurisdiction? Are the shares in certificated form? Can such security validly be granted under a New York or English law-governed document? Briefly, what is the procedure?

Security over shares in Cayman Islands companies, where the register of members is maintained in the Cayman Islands, is usually taken in the form of a legal or equitable mortgage, depending on whether the secured party wishes to take legal title to the shares prior to a default of the secured obligation. Different rules may apply if the register of members is maintained outside of the Cayman Islands or if the shares are in bearer form.

In accordance with Cayman Islands conflict of law rules, the appropriate law to govern any security over registered shares in a Cayman Islands company is determined according to the law applicable to the location of the register of members. Whilst it is possible to grant security over shares as a matter of other laws, enforcement of such security may prove problematic or difficult.

It is not possible to pledge registered shares under Cayman Islands law because title to the shares cannot be transferred by physical delivery. Any grant of security over registered shares that is called a "pledge" will typically fall into one of the mortgage categories, depending on its terms, or it may be entirely ineffective.

3.7 Can security be taken over inventory? Briefly, what is the procedure?

Security can be taken over inventory or stock by way of a fixed or floating charge. A floating charge is more common given the changing nature of inventory in the usual course of a grantor's business.

3.8 Can a company grant a security interest in order to secure its obligations (i) as a borrower under a credit facility, and (ii) as a guarantor of the obligations of other borrowers and/or guarantors of obligations under a credit facility (see below for questions relating to the giving of guarantees and financial assistance)?

A company can grant a security interest in order to secure its obligations as a borrower under a credit facility or as a guarantor of the obligations of other parties (see Section 2). Usual fiduciary duties applicable to directors' actions will apply in each case.

3.9 What are the notarisation, registration, stamp duty and other fees (whether related to property value or otherwise) in relation to security over different types of assets?

No stamp duties or other similar taxes are payable, unless the applicable security document is executed in or brought into the Cayman Islands. The amount of any applicable stamp duty will vary depending on the type of security document and the identity of the assets subject to the security interest. Unless the document needs to be executed in the Cayman Islands, it is common practice to execute documents outside of the Cayman Islands so that stamp duty is not levied. Court fees (of a nominal value) will fall due as part of any enforcement process.

3.10 Do the filing, notification or registration requirements in relation to security over different types of assets involve a significant amount of time or expense?

A company must make an entry in its register of mortgages and charges in respect of any security interest created by it in order to comply with section 54 of the Companies Law (2018 Revision). An LLC must make an entry on its register of mortgages and charges in a similar manner to an exempted company incorporated or referenced under the Companies Law, in accordance with Section 62(1) of the LLC Law. This step is usually undertaken by the registered office service provider of the company or LLC and can be completed in a very short time period.

Charges over certain assets, such as land, intellectual property rights, ships and aircraft, need to be registered at other specialist registries related to the asset in question.

3.11 Are any regulatory or similar consents required with respect to the creation of security?

Subject to any licensing restrictions that may apply to a regulated entity, no authorisations or consents are required by law from any governmental authorities or agencies or other official bodies in the Cayman Islands in connection with the grant of a security interest.

The directors of the company (or manager, as the case may be) or of an LLC granting the security interest should approve the terms and execution of the security document by way of board resolution in accordance with the company's articles of association or LLC's limited liability company agreement. If there is any question of lack of corporate benefit or a potential breach of directors' duties, it is recommended that the company also obtain a shareholders' resolution approving the grant of the security interest.

3.12 If the borrowings to be secured are under a revolving credit facility, are there any special priority or other concerns?

There are no special priority concerns regarding a revolving credit facility.

3.13 Are there particular documentary or execution requirements (notarisation, execution under power of attorney, counterparts, deeds)?

A number of key documentation issues exist, each of which depend on the form of the security document, whether the document contains a power of attorney and if the document is to be executed by way of deed. The key issues of note are: (i) an agreement to create a legal mortgage over land should be executed and delivered as a deed; (ii) a legal assignment must be in writing and signed by both parties; (iii) any power of attorney or security document containing a power of attorney must be executed by way of a deed to ensure compliance with the Powers of Attorney Law (1996 Revision); and (iv) where a deed is required, the relevant execution formalities are set out in the Companies Law (2018 Revision) and the LLC Law.

4 Financial Assistance

4.1 Are there prohibitions or restrictions on the ability of a company to guarantee and/or give security to support borrowings incurred to finance or refinance the direct or indirect acquisition of: (a) shares of the company; (b) shares of any company which directly or indirectly owns shares in the company; or (c) shares in a sister subsidiary?

(a) Shares of the company

No, there are no legislative prohibitions or restrictions under Cayman Islands law equivalent to the English law financial assistance rule.

(b) Shares of any company which directly or indirectly owns shares in the company

No, there are no legislative prohibitions or restrictions under Cayman Islands law equivalent to the English law financial assistance rule.

(c) Shares in a sister subsidiary

No, there are no legislative prohibitions or restrictions under Cayman Islands law equivalent to the English law financial assistance rule.

5 Syndicated Lending/Agency/Trustee/Transfers

5.1 Will your jurisdiction recognise the role of an agent or trustee and allow the agent or trustee (rather than each lender acting separately) to enforce the loan documentation and collateral security and to apply the proceeds from the collateral to the claims of all the lenders?

Cayman Islands law recognises the role of an agent or trustee, acting on behalf of all lenders, assuming the transaction documents provide for the relevant trust mechanics and the trust is properly constituted.

5.2 If an agent or trustee is not recognised in your jurisdiction, is an alternative mechanism available to achieve the effect referred to above which would allow one party to enforce claims on behalf of all the lenders so that individual lenders do not need to enforce their security separately?

This is not applicable.

5.3 Assume a loan is made to a company organised under the laws of your jurisdiction and guaranteed by a guarantor organised under the laws of your jurisdiction. If such loan is transferred by Lender A to Lender B, are there any special requirements necessary to make the loan and guarantee enforceable by Lender B?

There are no special requirements under Cayman Islands law to make the loan and guarantee enforceable by Lender B, provided that the novation/transfer mechanics in the applicable facility agreement are adhered to as a matter of the applicable governing law.

6 Withholding, Stamp and Other Taxes; Notarial and Other Costs

6.1 Are there any requirements to deduct or withhold tax from (a) interest payable on loans made to domestic or foreign lenders, or (b) the proceeds of a claim under a guarantee or the proceeds of enforcing security?

The Cayman Islands currently have no form of income, corporate or capital gains tax and no estate duty, inheritance tax or gift tax. Accordingly, no taxes, fees or charges (other than stamp duty) are payable either by direct assessment or withholding to the government or another taxing authority in the Cayman Islands under the laws of the Cayman Islands.

6.2 What tax incentives or other incentives are provided preferentially to foreign lenders? What taxes apply to foreign lenders with respect to their loans, mortgages or other security documents, either for the purposes of effectiveness or registration?

There are no tax incentives or other incentives under Cayman Islands law. See question 6.1.

6.3 Will any income of a foreign lender become taxable in your jurisdiction solely because of a loan to, or guarantee and/or grant of, security from a company in your jurisdiction?

No income of a foreign lender will become taxable in the Cayman Islands.

6.4 Will there be any other significant costs which would be incurred by foreign lenders in the grant of such loan/guarantee/security, such as notarial fees, etc.?

Other than, potentially, the payment of stamp duty and applicable court fees on enforcement, no other significant costs should be incurred by foreign lenders in the grant of any loan or the taking of the benefit of any guarantee or security interest.

6.5 Are there any adverse consequences for a company that is a borrower (such as under thin capitalisation principles) if some or all of the lenders are organised under the laws of a jurisdiction other than your own? Please disregard withholding tax concerns for purposes of this question.

Assuming that the lenders are not connected to the borrower, in principle there are no adverse consequences if the lenders are organised in a jurisdiction other than the Cayman Islands.

7 Judicial Enforcement

7.1 Will the courts in your jurisdiction recognise a governing law in a contract that is the law of another jurisdiction (a "foreign governing law")? Will courts in your jurisdiction enforce a contract that has a foreign governing law?

The courts of the Cayman Islands will observe and give effect to the choice of the applicable governing law (the "**Relevant Law**") of a contract assuming that the choice of the Relevant Law as the governing law of the applicable contract has been made in good faith and would be regarded as a valid and binding selection which will be upheld by the courts of that jurisdiction and any other relevant jurisdiction as a matter of the Relevant Law and all other relevant laws.

7.2 Will the courts in your jurisdiction recognise and enforce a judgment given against a company in New York courts or English courts (a "foreign judgment") without re-examination of the merits of the case?

Assuming that the choice of the Relevant Law (as defined in question 7.1 above) as the governing law of the applicable contract has been made in good faith and would be regarded as a valid and binding selection which will be upheld by the courts of the applicable jurisdiction (the "**Relevant Jurisdiction**") and any other relevant jurisdiction (other than the Cayman Islands) as a matter of the Relevant Law and all other relevant laws (other than the laws of the Cayman Islands), then although there is no statutory enforcement in the Cayman Islands of judgments obtained in the Relevant Jurisdiction, a judgment obtained in such jurisdiction will be recognised and enforced in the courts of the Cayman Islands at common law, without any re-examination of the merits of the underlying dispute, by an action commenced on the foreign judgment debt in the Grand Court of the Cayman Islands, provided such judgment is given by a foreign court of competent jurisdiction and is final, for a liquidated sum, not in respect of taxes or a fine or a penalty, and was not obtained in a manner, and is not of a kind, the enforcement of which is contrary to the public policy of the Cayman Islands.

7.3 Assuming a company is in payment default under a loan agreement or a guarantee agreement and has no legal defence to payment, approximately how long would it take for a foreign lender to (a) assuming the answer to question 7.1 is yes, file a suit against the company in a court in your jurisdiction, obtain a judgment, and enforce the judgment against the assets of the company, and (b) assuming the answer to question 7.2 is yes, enforce a foreign judgment in a court in your jurisdiction against the assets of the company?

Timing of any litigation will inevitably be dependent on a large number of variable factors (such as location of the defendant, defences raised, complexity of the proceedings and resistance to enforcement). Assuming the defendant is in the Cayman Islands and the matter is straightforward and uncontested, it is possible to obtain default or summary judgment within a short time period. Assuming there is no resistance to enforcement, it may be possible to complete the process in six months. If the defendant is outside the jurisdiction, the process may take substantially longer. The timing for enforcement of a judgment is also dependent on a number of variable factors. It may be possible to complete the process in two to three months, but it could take substantially longer.

7.4 With respect to enforcing collateral security, are there any significant restrictions which may impact the timing and value of enforcement, such as (a) a requirement for a public auction, or (b) regulatory consents?

Whilst there are no legislative requirements for a public auction or similar process in the Cayman Islands, liquidators owe fiduciary duties to the creditors and shareholders of a company to recover the best price possible (usually market value) for all assets of a company upon a liquidation. Recent case law has set a precedent for this in the case of enforcement over land located in the Cayman Islands. Receivers owe their primary duty to the secured party and will seek to recover sufficient funds to repay the debt due; however, they also have a duty to the obligor to recover the best price reasonably obtainable on a sale of the secured assets. Accordingly, public auction or a similar process may be appropriate in certain circumstances. Certain consents may also be required from the Monetary Authority if the obligor is a regulated entity.

7.5 Do restrictions apply to foreign lenders in the event of (a) filing suit against a company in your jurisdiction, or (b) foreclosure on collateral security?

There are no legislative restrictions on foreign lenders filing suit against a company in the Cayman Islands, assuming that they can establish that the Cayman Islands court has jurisdiction over the suit. There are no legislative restrictions applicable to foreclosure on collateral security.

7.6 Do the bankruptcy, reorganisation or similar laws in your jurisdiction provide for any kind of moratorium on enforcement of lender claims? If so, does the moratorium apply to the enforcement of collateral security?

No formal corporate rehabilitation procedure exists under either the Companies Law (2018 Revision) or the LLC Law, as is the case in England and Wales (administration) or in the United States (Chapter 11), that would give a company or LLC the benefit of moratorium provisions in the payment of its secured debts. Each of a Cayman Islands company and LLC can be subject to voluntary or involuntary winding up proceedings under the Companies Law (2018 Revision), although it is possible for a court to appoint a provisional liquidator after the presentation of a petition for the winding up of a company or LLC but before an order for the winding up of the company or LLC is made where, for example, there is an immediate need to take actions to safeguard assets for creditors. There is also a growing practice in the Cayman Islands for provisional liquidators to be appointed with the principal objective of preparing a scheme of arrangement with the aim of avoiding a formal winding up (see further below). While there is an automatic stay of proceedings against the entity when an order for winding up has been made and on the appointment of a provisional liquidator, the stay does not prevent a secured creditor from enforcing its security interest.

Court-supervised debt restructurings are implemented through a scheme of arrangement. A scheme of arrangement involves a compromise or arrangement between a company and its creditors and/or members. In an insolvency or potential insolvency situation, schemes are principally used to: (i) restructure the company's debts when the company is in financial difficulties, with a view to the company continuing its operations (either on a stand-alone basis or within provisional liquidation proceedings); or (ii) reach a compromise with creditors following commencement of liquidation (the scheme being used as the mechanism for making distributions in the liquidation). No protection from creditor action is afforded if a scheme of arrangement is used outside of liquidation or provisional liquidation proceedings. Where there are different classes of creditors involved, each class is required to hold separate meetings to vote on the scheme proposals. The scheme will be approved by the company's creditors if a majority (i.e. over 50%) in number, representing 75% in value of each class of creditors, present and attending, either in person or by proxy, vote in favour of the scheme. Once approved, the scheme will be required to be sanctioned by the Court and delivered to the Registrar of Companies to become binding on all affected parties, regardless of whether and how they voted at the class meeting(s). A scheme of arrangement is broadly analogous to a plan of reorganisation in a Chapter 11.

7.7 Will the courts in your jurisdiction recognise and enforce an arbitral award given against the company without re-examination of the merits?

The courts of the Cayman Islands will recognise and enforce arbitral awards made pursuant to an arbitration agreement in a jurisdiction which is a party to the United Nations Convention on the Recognition and Enforcement of Foreign Arbitral Awards (the "**New York Convention**").

Although there is no statutory enforcement of arbitral awards made in jurisdictions not party to the New York Convention, the courts of the Cayman Islands will recognise and enforce such arbitral awards provided that (a) the parties have submitted to the arbitration by an agreement which is valid by its governing law, and (b) the arbitral award is valid and final according to the law which governs the arbitration proceedings. The arbitral award will not be regarded as final by a Cayman Islands court unless the arbitral tribunal has disposed of all the issues itself. A Cayman Islands court will not, however, recognise or enforce such arbitral awards if: (a) under the submission agreement and the law applicable thereto, the arbitrators have no jurisdiction to make the award; (b) it was obtained by fraud; (c) its recognition or, as the case may be, enforcement would be contrary to public policy; or (d) the proceedings in which it was obtained were opposed to natural justice.

8 Bankruptcy Proceedings

8.1 How does a bankruptcy proceeding in respect of a company affect the ability of a lender to enforce its rights as a secured party over the collateral security?

In accordance with the Companies Law (2018 Revision), when a winding up order is made or a provisional liquidator is appointed, no suit, action or other proceedings, including criminal proceedings, shall be proceeded with or commenced against the company or LLC except with the leave of the court and subject to such terms as the court may impose. This prohibition in our view extends to judicial proceedings and does not include security enforcement methods which do not require an order of the court in the Cayman Islands. Furthermore, subject to any debts preferred by law, each of the Companies Law (2018 Revision) and the LLC Law provide that secured creditors may enforce their security notwithstanding that a winding up order has been made in respect of the applicable company or LLC.

8.2 Are there any preference periods, clawback rights or other preferential creditors' rights (e.g., tax debts, employees' claims) with respect to the security?

The enforceability of any security document will be subject to general insolvency rules applicable to companies and LLCs in the Cayman Islands including voidable preferences and transactions effected at an undervalue.

A secured party holding a fixed charge will, notwithstanding that a winding up order has been made, be entitled to enforce his security without the leave of the Cayman Islands court and without reference to the liquidator. However, if the security created by the relevant security document is treated as a floating charge, then debts preferred under Cayman Islands law will have priority over the secured party on a liquidation of the company or LLC.

In addition, subsequent purchasers, mortgagees, chargees, lienholders and execution creditors in respect of the assets subject to the floating charge are likely to have priority over the secured party, although this will depend upon such factors as the terms of the floating charge, in particular the scope of any restrictions, whether any subsequent purchasers, mortgagees or chargees have knowledge of any restrictions and the circumstances in which any subsequent transactions arise.

8.3 Are there any entities that are excluded from bankruptcy proceedings and, if so, what is the applicable legislation?

Neither companies nor LLCs incorporated in the Cayman Islands are excluded from proceedings under the Companies Law (2018 Revision), the LLC Law or any other applicable laws or regulations.

8.4 Are there any processes other than court proceedings that are available to a creditor to seize the assets of a company in an enforcement?

The Companies Law (2018 Revision) provides that, at any time after the presentation of a winding up petition and before a winding up order has been made, the company or any creditor or contributory may (a) where any action or proceeding against the company, including a criminal proceeding, is pending in a summary court, the Cayman Islands court, the Court of Appeal or the Privy Council, apply to the court in which the action or proceeding is pending for a stay of proceedings therein, and (b) where any action or proceeding is pending against the company in a foreign court, apply to the court for an injunction to restrain further proceedings therein, and the court to which application is made may, as the case may be, stay or restrain the proceedings accordingly on such terms as it thinks fit. On a voluntary winding up, there is no automatic moratorium. The Cayman Islands court does, however, have discretion to impose a moratorium on a blanket or a case-by-case basis. In practice, the court would only exercise its discretion if there was any doubt about the company's solvency.

As set out in question 7.6, a creditor of a company or LLC may have a compromise or arrangement imposed upon him under the Companies Law (2018 Revision) if a majority in number representing three quarters or more in value of the creditors (or class of creditors including the affected creditor) have approved the compromise or arrangement and it has been sanctioned by the Grand Court of the Cayman Islands. Although this is not a mandatory insolvency provision, it is a circumstance in which a creditor of a company or LLC may be made subject to an arrangement or compromise affecting his rights without his consent. It would not, however, affect the enforcement of security rights.

9 Jurisdiction and Waiver of Immunity

9.1 Is a party's submission to a foreign jurisdiction legally binding and enforceable under the laws of your jurisdiction?

The submission by a company or LLC in a security document to the jurisdiction of the courts of a particular jurisdiction will be legal, valid and binding on the company or LLC assuming that the same is true under the governing law of the security document and under the laws, rules and procedures applying in the courts of that jurisdiction.

9.2 Is a party's waiver of sovereign immunity legally binding and enforceable under the laws of your jurisdiction?

Companies and LLCs can, as a matter of contract, waive immunity for any legal proceedings in the Cayman Islands. However, subject to certain exceptions, companies may receive the benefit of sovereign immunity under the State Immunity Act of the United Kingdom, which has been extended to the Cayman Islands by statutory order.

10 Licensing

10.1 What are the licensing and other eligibility requirements in your jurisdiction for lenders to a company in your jurisdiction, if any? Are these licensing and eligibility requirements different for a "foreign" lender (i.e. a lender that is not located in your jurisdiction)? In connection with any such requirements, is a distinction made under the laws of your jurisdiction between a lender that is a bank *versus* a lender that is a non-bank? If there are such requirements in your jurisdiction, what are the consequences for a lender that has not satisfied such requirements but has nonetheless made a loan to a company in your jurisdiction? What are the licensing and other eligibility requirements in your jurisdiction for an agent under a syndicated facility for lenders to a company in your jurisdiction?

There are no licensing or eligibility requirements under Cayman Islands law for lenders to a company or LLC. Assuming that the lenders are not incorporated in or registered under Cayman Islands law and all the activities of such parties have not been and will not be carried on through a place of business in the Cayman Islands, then the lenders will not be required to be licensed in the Cayman Islands solely in order to provide a loan to a company or LLC. Any lenders that are incorporated or registered in the Cayman Islands or otherwise carrying on business in the Cayman Islands will be required to register and be licensed, as applicable, in accordance with Cayman Islands law.

11 Other Matters

11.1 Are there any other material considerations which should be taken into account by lenders when participating in financings in your jurisdiction?

The questions and answers set out in this chapter cover the main legal considerations for secured financings under Cayman Islands law.

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Chile

Carey

Diego Peralta

1 Overview

1.1 What are the main trends/significant developments in the lending markets in your jurisdiction?

According to the Chilean Superintendency of Banks and Financial Institutions ("SBIF"), during the 12 months leading up to December 2018, the growth of credit was 9.93%, compared to the modest 2.54% in December 2017. This is explained by faster commercial lending (with a 9.18% growth over the year). The housing sector also grew by 8.32% compared to 7.88% the year before, and the number of loans increased by 16.8%, still with low interest rates. Consumer lending grew by 16.86% (compared to 4.23%) during the same period in the previous year. Provisions remained stable (2.44%, compared to 2.44% during 2017). It should be noted that in December 2018, two major retail acquisitions (by Walmart and Falabella) were transferred into banks (BCI and Banco Falabella, respectively), which explains the growth in consumer lending.

A major reform to the Banking Law was approved by Congress and enacted in January 2019, meaning the banking industry in Chile will adopt the Basel III recommendations, with the formation of a new regulator (the Financial Market Commission) and a new resolution process.

1.2 What are some significant lending transactions that have taken place in your jurisdiction in recent years?

There is no separate information pertaining to local lending transactions, but, generally speaking, the largest sector of borrowers is real estate developers, followed by commerce (retail) and construction.

Nonetheless, in the last two years, Carey has advised, among others, the following clients in significant lending transactions:

- TIANQI LITHIUM CORPORATION on a Senior Credit Facility Agreement for USD 2.5 billion and on a mezzanine financing for USD 1 billion.
- TRANSELEC, through one of its affiliates on a project financing transaction for up to USD 375 million. The financing was provided by Export Development Canada, KfW Ipex Bank GmbH and MUFG Bank.
- Export Development Canada (EDC) in a loan agreement to Codelco for USD 300 million.

2 Guarantees

2.1 Can a company guarantee borrowings of one or more other members of its corporate group (see below for questions relating to fraudulent transfer/financial assistance)?

Following certain corporate requirements depending on the type of company involved, provided the guarantor benefits somehow from these operations, and subject to applicable insolvency, moratorium or similar laws relating to or affecting creditors' rights generally, and general principles of fairness (regardless of whether it is considered in a proceeding in equity or at law), there is no restriction for this type of guarantee.

Additionally, under Chilean general banking law, banks are not authorised to grant mortgages or pledges over their own physical assets, unless to guarantee payment of the purchase price thereof. Considering this, it has been construed that banks can provide guarantees over financial assets subject to certain restrictions regulated by the SBIF.

2.2 Are there enforceability or other concerns (such as director liability) if only a disproportionately small (or no) benefit to the guaranteeing/securing company can be shown?

Under the Chilean Corporations Law, directors of corporations are jointly and severally liable for any damages caused to shareholders for their negligent or malicious actions, making it highly unlikely that the approval of a board would be secured for such a disadvantageous operation. Should the agreements cause the company's insolvency, there are actions for revocation which apply once the reorganisation or liquidation procedures have started, according to Chilean insolvency law. Among the agreements that can be revoked are any pledge or mortgage granted by the insolvent company within a year before the insolvency proceedings (to guarantee debts previously acquired), and any act or agreement (including granting guarantees) entered into within two years before the insolvency proceedings, provided that (i) the counterparty knew of the company's poor state of business, and (ii) the agreement has caused damage to the other creditors, where damage means that terms and conditions were distant from the market's at the time of the agreement. On the other hand, article 2,468 of the Chilean Civil Code grants the creditors of an insolvent debtor the right to request the revocation of certain agreements entered into by such debtor (*acción pauliana*), provided that: (i) the transaction causes damages to the creditors (the transaction executed increased the insolvency of the debtor); (ii) the debtor was aware of its poor business condition at the time of entering into such act or contract; and (iii) in case of an onerous act or contract, the counterparty of the debtor was also aware of the poor business condition of the debtor.

2.3 Is lack of corporate power an issue?

Yes. The Chilean Civil Code establishes in articles 2,151 and 2,160 that the principal shall not be obliged toward third parties by acts or agreements entered into by its agent if (i) the latter did not mention that he was acting on behalf of the principal, and (ii) the agent acts beyond the limits of its mandate. Ratification by the principal of the non-empowered actions may be a solution for the lack of corporate power.

2.4 Are any governmental or other consents or filings, or other formalities (such as shareholder approval), required?

There are no governmental approvals required, but, depending on the company's structure, the value and the type of guarantee, there are certain corporate consents which are required. If the guarantor is a corporation, in order to guarantee third-party obligations (unless the guaranteed obligations belong to a company that is a subsidiary of the guarantor, in which case the Board's approval suffices, and also with an exception for lender banks) and also if the value of the guaranteed obligations exceed 50% of the guaranteeing corporation's assets, an extraordinary shareholders' meeting must be called in order to grant approval.

2.5 Are net worth, solvency or similar limitations imposed on the amount of a guarantee?

No. Nevertheless, any operation executed between related parties needs to be for the company's benefit, complying with the market's standards for price, terms and conditions, and also the required approval if the guaranteed value exceeds 50% of the guarantor's assets, as explained above.

2.6 Are there any exchange control or similar obstacles to enforcement of a guarantee?

There are no exchange control regulations. Payment in foreign currency is possible if the parties have agreed such form of payment. In order to enforce a guarantee (as an accessory obligation) it is required that the secured obligations comply with certain requirements, and in case of obligations governed by foreign law and subject to foreign jurisdiction, *exequatur* procedures have to be conducted. Subject to Law No. 18,010 regarding lending operations, transactions agreed in a foreign currency shall be payable according to the seller exchange rate applicable on date of payment, which must be certified by a Chilean commercial bank. Please refer to our answers to questions 7.2, 7.3 and 7.7 in regard to the enforcement of foreign judgments procedure.

3 Collateral Security

3.1 What types of collateral are available to secure lending obligations?

Securities can be classified into two big groups: (i) guarantees over assets or rights *in rem*; and (ii) personal guarantees.

i) **Guarantees over assets**: There are guarantees over moveable assets (pledge agreements) and guarantees over real estate, vessels and aircraft (mortgage agreements).

a) Guarantees over moveable assets:

- **Civil Pledge**: This has a wide scope, as it may apply to any moveable property, including all kinds of personal rights and credits. Any obligation may be secured by this pledge, including obligations to act, or to refrain from acting. However, it is not commonly used, as the pledgor must deliver the pledged asset, losing the ability to use and enjoy it.
- **Commercial pledge**: This aims to secure commercial obligations. Though it is very similar to the civil pledge, unlike the latter, the material possession by the pledgee is not required, as it may be delivered to a third-party bailee. It is not possible to secure future obligations – only currently existing and determined obligations – and its only requirement is that the material possession of the pledged property is not held by the pledgor. The Commerce Code requires certain formalities for granting the pledge in order for the pledgee to be able to exercise its right to be paid preferentially: (i) the execution of the pledge agreement by means of a public deed, or by private instrument entered into a Chilean Notary Public's registry; (ii) the amount of the debt secured and the pledged asset must be defined in the agreement; and (iii) for a pledge granted over a credit, the debtor of the credit must be notified not to make any payment under the pledged credit but to the creditor.
- **Banking pledge over securities**: This may be granted over bearer securities of any kind in favour of banks and other financial institutions, even those that are foreign. This pledge may secure all current or future obligations of the pledgor with the pledgee. It only requires the handing over of the instrument by the pledgor to the pledgee. Credits payable to the order (i.e., not in bearer form) must be endorsed as a guarantee to the pledgee. Finally, shares shall be pledged by means of a public deed or private instrument, which must be notified to the issuer by a Notary Public. This pledge does not allow the pledgor to remain in material possession of the pledged assets. It is worth noting that the Constitutional Court of Chile ruled in one case that this procedure was not compliant with the due process constitutional protection, thus it declared the same unconstitutional. This is not a general ruling, but it may show a tendency.
- **Pledge without conveyance** ("**PwC**"): This allows any kind of corporeal or incorporeal, present or future, moveable assets to be pledged in order to secure own or third-party obligations, present or future, irrespective of whether such obligations are determined or undetermined at the time of the pledge agreement. It must be executed either by means of a public deed or a private instrument, with the signatures of the appearing parties authorised by a Chilean Notary Public, before the instrument is entered into a Chilean Notary Public's registry. The PwC agreement must contain at least the following references: (i) the identities of the parties; (ii) the existing secured obligations or the specification that the pledge secures present and future obligations (*cláusula de garantía general*); (iii) the identification of the pledged assets; and (iv) the determined or undetermined amount to which the pledge is limited or the extent to which the pledge secures several obligations, if applicable. The PwC agreement must be registered in a special registry called the Pledge without Conveyance Registry. Upon its registration, the pledge without conveyance is enforceable upon third parties.

- **Pledge over deposited securities**: A new pledge was created at the end of 2016 to simplify the pledging of securities deposited with depository entities. The latter shall need to enter into a master agreement with all depositors to allow this type of pledge.

b) **Guarantees over real estate**:

- **Mortgages**: Granted by means of a public deed, a mortgage allows not only existing and determined obligations but present and future obligations of the borrower (*cláusula de garantía general*) to be secured. Mortgages are perfected by means of registration in the corresponding Mortgage Lien Registry. Generally, the mortgage deed will also contemplate a prohibition to transfer, convey and enter into acts or contracts with respect to the mortgaged property.
- Likewise, mortgages can be granted over mining concessions and water rights, which need to be registered in the same manner in the Custodian of Mines' Registry or the Real Estate Registrar Property Registry, as appropriate.
- **Guarantees over vessels and aircraft**: Mortgages can be granted over vessels and airplanes fulfilling certain requirements, such as the vessel or airplane being duly registered in the corresponding Registry and the agreement being granted by means of a public deed.

ii) **Personal guarantees**: The most common personal guarantees in Chile are sureties (*fianzas*) and joint and several guarantees (*fianzas y codeudas solidarias*). By means of sureties, one or more third parties are bound to pay the debtor's obligation in the event such debtor does not pay the secured obligation. By virtue of joint and several guarantees, the liability for default is enforceable directly against all of the debtor(s) and guarantors as a group or against any one of them as an individual at the choice of the enforcing creditor. The main characteristic of the joint and several guarantees is that guarantors become equally liable to the creditor, just as the primary debtor. Therefore, they are not entitled to request that (i) the debt be claimed first from the borrowers and only if they do not pay, then be collected from them, and (ii) the debt be divided equally or proportionally among the various guarantors. Under Chilean law, guarantees are an accessory to the main obligations and cannot exceed the amount of such obligations. This is expressly regulated for sureties, where it is stated that they cannot exceed the main obligation being guaranteed and cannot be granted in terms more onerous than those of the main obligor, but can be granted in terms more effective (like securing its obligations as guarantor through a mortgage, for example). The Chilean Civil Code does not provide for any formalities at all to grant sureties but if the obligation intended to be secured is a commercial obligation, it must be granted in writing. Where the guarantor of a surety and a joint several co-debt is an individual married under joint ownership of the matrimonial estate (*sociedad conyugal*), the prior spouse's consent is required.

iii) **Conditional assignments of rights**: This is a widely used tool in Chile to safeguard creditors' rights in an event of default.

3.2 Is it possible to give asset security by means of a general security agreement or is an agreement required in relation to each type of asset? Briefly, what is the procedure?

It is not possible to dispose or grant a security over all of an entity's assets. The guarantee document must clearly identify which assets are being pledged (or mortgaged). Additionally, each type of security requires specific formalities for perfection (see our answer to question 3.1 above). The most advisable manner is to have an agreement for every type of asset, since each has a different registration process.

3.3 Can collateral security be taken over real property (land), plant, machinery and equipment? Briefly, what is the procedure?

Yes. Please refer to the answer to question 3.1.

3.4 Can collateral security be taken over receivables? Briefly, what is the procedure? Are debtors required to be notified of the security?

Yes. Please refer to the answer to question 3.1, since the receivables are credits.

3.5 Can collateral security be taken over cash deposited in bank accounts? Briefly, what is the procedure?

Yes, it can be taken either by means of a commercial pledge or a PwC. The procedure is briefly explained in the answer to question 3.1.

3.6 Can collateral security be taken over shares in companies incorporated in your jurisdiction? Are the shares in certificated form? Can such security validly be granted under a New York or English law governed document? Briefly, what is the procedure?

Yes. All the pledges set forth by Chilean law can be granted over shares. Please refer to our answer to question 3.1. The Chilean Corporations Law states that any liens or rights *in rem* over shares of a company must be notified by a minister of faith, who must leave a record thereof in the company's shareholders' registry. Shares can be issued either in certificated form, or dematerialised in case of corporations and companies limited by shares.

According to the Chilean Civil Code, assets located in Chile are subject to Chilean law, and hence, the pledge shall be granted in accordance with Chilean law.

3.7 Can security be taken over inventory? Briefly, what is the procedure?

Yes. Please refer to the answer to question 3.1.

3.8 Can a company grant a security interest in order to secure its obligations (i) as a borrower under a credit facility, and (ii) as a guarantor of the obligations of other borrowers and/or guarantors of obligations under a credit facility (see below for questions relating to the giving of guarantees and financial assistance)?

Yes, it can. Please refer to our answer to question 2.4 above.

3.9 What are the notarisation, registration, stamp duty and other fees (whether related to property value or otherwise) in relation to security over different types of assets?

It mainly depends on the kind of collateral the company is granting. Excepting civil and commercial pledges, all other collateral agreements must be executed by means of a public deed or by a private document which must be authorised and registered by a Notary Public. Therefore, notarisation expenses are common to all kinds of collateral over all kinds of assets.

In case of mortgages, as mentioned above, the agreement has to be registered in the relevant Mortgage Lien Registry and in the Prohibitions Registry of the Real Estate Custodian, which charges a fee as well.

In case of a PwC, it is necessary to register it in the PwC Registry, which also charges a fee. If a PwC is granted over shares which are deposited in the Central Securities Deposit, these must be registered in an electronic pledge registry, which also charges a fee for its services.

3.10 Do the filing, notification or registration requirements in relation to security over different types of assets involve a significant amount of time or expense?

No, expenses are generally not material, and in general, procedures do not take long, although it depends on the registrar and workload at the time of the registration request The PwC Registry charges a fixed fee of CLP30,000 (approx. USD50) for each such registration.

3.11 Are any regulatory or similar consents required with respect to the creation of security?

No, there are not.

3.12 If the borrowings to be secured are under a revolving credit facility, are there any special priority or other concerns?

No, there are not.

3.13 Are there particular documentary or execution requirements (notarisation, execution under power of attorney, counterparts, deeds)?

Yes; please refer to the answers above. In case of the execution of foreign agreements in Chile, documents must be apostilled and if not in Spanish, shall need to be translated to be presented in courts.

4 Financial Assistance

4.1 Are there prohibitions or restrictions on the ability of a company to guarantee and/or give security to support borrowings incurred to finance or refinance the direct or indirect acquisition of: (a) shares of the company; (b) shares of any company which directly or indirectly owns shares in the company; or (c) shares in a sister subsidiary?

(a) Shares of the company

There are no such prohibitions or restrictions under Chilean law, except for the requirements mentioned in our answers to questions 2.4 and 2.5.

(b) Shares of any company which directly or indirectly owns shares in the company

There are no such prohibitions or restrictions under Chilean law, except for the requirements mentioned in our answers to questions 2.4 and 2.5.

(c) Shares in a sister subsidiary

There are no such prohibitions or restrictions under Chilean law, except for the requirements mentioned in our answers to questions 2.4 and 2.5.

5 Syndicated Lending/Agency/Trustee/Transfers

5.1 Will your jurisdiction recognise the role of an agent or trustee and allow the agent or trustee (rather than each lender acting separately) to enforce the loan documentation and collateral security and to apply the proceeds from the collateral to the claims of all the lenders?

Yes. Their appointment requires the existence of at least two creditors, who may grant the authorities to manage the collateral as well as enforcement and release of the same in case of an event of default, among other duties and attributions. In the case of a single lender, it can also issue a mandate for a local entity/person to act on its behalf, serving the same purpose as a collateral agent with the same powers.

5.2 If an agent or trustee is not recognised in your jurisdiction, is an alternative mechanism available to achieve the effect referred to above which would allow one party to enforce claims on behalf of all the lenders so that individual lenders do not need to enforce their security separately?

In the case of a single lender, it can also issue a mandate for a local entity/person to act on its behalf, serving the same purpose as a collateral agent with the same powers.

5.3 Assume a loan is made to a company organised under the laws of your jurisdiction and guaranteed by a guarantor organised under the laws of your jurisdiction. If such loan is transferred by Lender A to Lender B, are there any special requirements necessary to make the loan and guarantee enforceable by Lender B?

Yes. Under the Chilean Civil Code, it is necessary to duly notify the credit assignment to the debtor. Otherwise, the assignment cannot be enforced against the debtor.

Regarding the guarantees, the Chilean Civil Code provides that assignment of credits encompasses assignment of guarantees securing the same, by operation of law.

In all such cases, if there is a foreign lender lending to a Chilean, the changes must be reported to the Central Bank of Chile.

6 Withholding, Stamp and Other Taxes; Notarial and Other Costs

6.1 Are there any requirements to deduct or withhold tax from (a) interest payable on loans made to domestic or foreign lenders, or (b) the proceeds of a claim under a guarantee or the proceeds of enforcing security?

(a) As a general rule, interest paid by Chilean taxpayers to foreign lenders is subject to a 35% withholding tax. However, a reduced 4% tax rate is applicable to certain interest payments (see question 6.2). The above is notwithstanding the existence of double taxation treaties. The payment of interest by Chilean taxpayers to domestic lenders is not subject to withholding tax.

(b) Payments of interest abroad upon enforcement of a guarantee could be subject to withholding tax depending on the reimbursement rights that the guarantor has against the main obligor.

6.2 What tax incentives or other incentives are provided preferentially to foreign lenders? What taxes apply to foreign lenders with respect to their loans, mortgages or other security documents, either for the purposes of effectiveness or registration?

Interest paid to foreign banks or foreign financial institutions complying with the requirements set by Chilean tax legislation benefit from a reduced withholding tax rate of 4%. Interest payments to foreign individuals resident in a country where there is a tax treaty in place with Chile may also benefit from a reduced withholding tax rate.

Stamp tax applies to documents evidencing indebtedness for borrowed money, including loan documents, notes and bond issuances. The tax is applied over the principal amount of the loan and its current rate is 0.066% of the principal amount multiplied by the number of months-to-maturity of the loan, with a maximum of 12 months (i.e. 0.8%). In case of loans payable on-demand, the applicable rate is 0.332%.

6.3 Will any income of a foreign lender become taxable in your jurisdiction solely because of a loan to, or guarantee and/or grant of, security from a company in your jurisdiction?

No, it will not.

6.4 Will there be any other significant costs which would be incurred by foreign lenders in the grant of such loan/guarantee/security, such as notarial fees, etc.?

There are transactional fees and translation costs, but as explained in our answer to question 3.9, they are not significant.

6.5 Are there any adverse consequences for a company that is a borrower (such as under thin capitalisation principles) if some or all of the lenders are organised under the laws of a jurisdiction other than your own? Please disregard withholding tax concerns for purposes of this question.

Under Chilean income tax law, thin capitalisation rules are triggered when a Chilean-resident taxpayer pays interest or other financing expenses (e.g. services, commissions, expenses reimbursements) to a related party abroad under a reduced withholding tax rate from the 35%. Per the thin capitalisation rules, any interest (or similar) payments made abroad to a related party and attributed to excessive indebtedness are subject to a 35% tax payable by the debtor. The withholding tax applicable to the payments made by the Chilean resident taxpayer can be used as a credit against such 35% tax.

A taxpayer will be deemed to have "excessive indebtedness" if its total indebtedness (related and non-related) is greater than three times its tax equity at the end of the year when payments were made to related parties.

7 Judicial Enforcement

7.1 Will the courts in your jurisdiction recognise a governing law in a contract that is the law of another jurisdiction (a "foreign governing law")? Will courts in your jurisdiction enforce a contract that has a foreign governing law?

Yes, taking into consideration the existence of a connecting factor with the parties involved. However, according to article 16 of the Chilean Civil Code and article 105 of the Private International Law Code (the "Bustamante Code"), assets are governed by the *lex situs* (the law of the jurisdiction where the assets are located), thus assets of any kind located in Chile are governed by Chilean laws. In consequence, generally speaking, a choice of law of a court in Chile will be based on the *lex situs* of the charged assets.

7.2 Will the courts in your jurisdiction recognise and enforce a judgment given against a company in New York courts or English courts (a "foreign judgment") without re-examination of the merits of the case?

Yes. Chilean courts would enforce an English/New York judgment without re-examination of the merits, provided legal requirements are met and there are no public policy considerations and to the extent the judgment complies with a proceeding called "*exequatur*" which must be followed before the Chilean Supreme Court.

7.3 Assuming a company is in payment default under a loan agreement or a guarantee agreement and has no legal defence to payment, approximately how long would it take for a foreign lender to (a) assuming the answer to question 7.1 is yes, file a suit against the company in a court in your jurisdiction, obtain a judgment, and enforce the judgment against the assets of the company, and (b) assuming the answer to question 7.2 is yes, enforce a foreign judgment in a court in your jurisdiction against the assets of the company?

(a) In general, disputes are resolved in the first instance by a lower court, which may take from two to four years. Rulings and judgments of a lower court may be reviewed in second instance by a Court of Appeals, which may take from one to two years. Beyond that, some remedies may be claimed before the Supreme Court, which may take from one to two years. Therefore, a common civil proceeding may take up to eight years. In addition, enforcement of judgments is generally executed by means of an enforcement proceeding, which may take around one year.

(b) The *exequatur* proceeding itself may usually take around six to eight months. Once the *exequatur* is obtained, the enforcement proceeding may usually take around one year, although we have obtained payment in a New York-issued ruling in a three-month period.

7.4 With respect to enforcing collateral security, are there any significant restrictions which may impact the timing and value of enforcement, such as (a) a requirement for a public auction, or (b) regulatory consents?

Yes. The enforcement of collateral security located in Chile must be made in Chile, before the competent Chilean court, in accordance with the rules for the so-called summary proceeding (*juicio ejecutivo*) contained in the Chilean Code of Civil Procedure. This procedure provides a very brief discussion stage, a stage of liquidation and subsequent public auction, which is held by auctioneers appointed by the court. This last stage can take a long time and the proceeds of the auction may be different from the expected ones.

7.5 Do restrictions apply to foreign lenders in the event of (a) filing suit against a company in your jurisdiction, or (b) foreclosure on collateral security?

No, they do not.

7.6 Do the bankruptcy, reorganisation or similar laws in your jurisdiction provide for any kind of moratorium on enforcement of lender claims? If so, does the moratorium apply to the enforcement of collateral security?

Yes. According to Chilean insolvency law, during a term of 30 days as of the legal notice of the reorganisation resolution which appoints a supervisor for the insolvency proceeding ("**Veedor**"), the debtor will be protected by the Insolvency Financial Protection (*Protección Financiera Concursal*), during which neither the declaration nor the initiation of a liquidation proceeding against the debtor or foreclosures can take place, nor individual foreclosures, any kind of executions or restitutions in lease trials may be initiated and, among others, all agreements executed by the debtor will maintain their effectiveness and payment conditions. The credits that contravene this restriction will be postponed in payment until all of the creditors have been paid off. This 30-day period may be extended under certain circumstances for two more 30-day periods. Personal guarantees issued by third parties can be foreclosed nonetheless.

7.7 Will the courts in your jurisdiction recognise and enforce an arbitral award given against the company without re-examination of the merits?

Yes. Foreign arbitral awards are recognised and enforced in Chile, subject to an *exequatur* from the Supreme Court, which will be granted provided legal requirements are met and there are no public policy considerations, without re-examination of the merits.

8 Bankruptcy Proceedings

8.1 How does a bankruptcy proceeding in respect of a company affect the ability of a lender to enforce its rights as a secured party over the collateral security?

Please see our answer to question 7.6 above.

8.2 Are there any preference periods, clawback rights or other preferential creditors' rights (e.g., tax debts, employees' claims) with respect to the security?

According to Chilean insolvency law and the Chilean Civil Code, there is a scale of preference, according to which debts are paid. The first class, which includes judicial costs, administrative and liquidation fees, labour wages, severance payments and surcharge and withholding taxes, has preference over all other credits. The second class includes the rights of the pledgee over the pledged asset. Mortgagees prefer every other credit, including first class credits, over the mortgaged asset; nevertheless, if there are not enough assets to cover the debts, the first class gives preference to the mortgagee over the mortgaged asset.

8.3 Are there any entities that are excluded from bankruptcy proceedings and, if so, what is the applicable legislation?

Banks and the Republic and its agencies and municipalities are excluded. Mutual, investment and pension funds are deemed a created patrimony that adopt an independent existence from their owner in order to serve a particular and autonomous purpose; thus they are not considered a legal entity. Their managers (corporations) might be declared insolvent.

8.4 Are there any processes other than court proceedings that are available to a creditor to seize the assets of a company in an enforcement?

No, there are not.

9 Jurisdiction and Waiver of Immunity

9.1 Is a party's submission to a foreign jurisdiction legally binding and enforceable under the laws of your jurisdiction?

Yes, it is. Nonetheless, the Republic and its agencies and the Central Bank of Chile have certain restrictions and sometimes they may not submit to foreign jurisdiction.

9.2 Is a party's waiver of sovereign immunity legally binding and enforceable under the laws of your jurisdiction?

Yes, it is. Nonetheless, the Republic and its agencies have certain restrictions and sometimes they may not waive sovereign immunity.

10 Licensing

10.1 What are the licensing and other eligibility requirements in your jurisdiction for lenders to a company in your jurisdiction, if any? Are these licensing and eligibility requirements different for a "foreign" lender (i.e. a lender that is not located in your jurisdiction)? In connection with any such requirements, is a distinction made under the laws of your jurisdiction between a lender that is a bank *versus* a lender that is a non-bank? If there are such requirements in your jurisdiction, what are the consequences for a lender that has not satisfied such requirements but has nonetheless made a loan to a company in your jurisdiction? What are the licensing and other eligibility requirements in your jurisdiction for an agent under a syndicated facility for lenders to a company in your jurisdiction?

There are no licence or permission requirements to perform lending operations in Chile.

11 Other Matters

11.1 Are there any other material considerations which should be taken into account by lenders when participating in financings in your jurisdiction?

There are regulations for the prepayment for local loans, which are not applicable to cross-border loans. Additionally, there is no interest rate limit for loans granted to Chileans by foreign or international financial institutions or banks.

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1 Overview

1.1 What are the main trends/significant developments in the lending markets in your jurisdiction?

The loan markets in the People's Republic of China (the "**PRC**") continued to be active in 2018. According to financial statistics released by the People's Bank of China (the "**PBOC**") during 2018, bank loans jumped 13.5% year-on-year to RMB 16.17 trillion, an increase of RMB 2.64 trillion compared to the figure for 2017.

As China's economy enters the "new normal" and undergoes significant transformations and reforms, China has set two major tasks in the financial sector: (1) serving the real economy; and (2) preventing and resolving financial risks.

In 2017, as ways of serving the real economy, PBOC continues to guide financial institutions to increase their support for private, small and micro enterprises, actively promote bond and equity financing by private enterprises and encourage local governments to set up private enterprise financing funds, and increase support for high-tech enterprises, emerging sectors and the structural transformation and upgrading of the manufacturing sector.

China's financial sector regulators have also continued focusing their efforts on preventing and resolving financial risks. Among others, the China Banking Regulatory Commission (the "**CBRC**") issued a new rule to tighten supervision on entrusted lending (which had been commonly used to structure shadow banking products). Regulators have also issued new rules in 2017 to address internet lending-related risks, and to enhance financial risk monitoring, assessment and disposal mechanisms to improve supervision on financial institutions.

China has also significantly revised regulation on cross-border investments. Perhaps the most significant rule affecting cross-border acquisition dominated by PRC outbound investors and the acquisition financing structure (in particular, the credit enhance arrangement thereof) is the new rule on outbound investment issued by the National Development and Reform Commission ("**NDRC**"), which came into force on 1 March 2018 and replaced previous legislation. Separately, the State Administration for Foreign Exchange ("**SAFE**") also issued a rule at the end of 2017 to supplement the previous rule on cross-border security/guarantees, which also has significant influence on the cross-border financing market where security/guarantee from the PRC is involved.

1.2 What are some significant lending transactions that have taken place in your jurisdiction in recent years?

Outbound investment activity continues to remain strong and has given rise to several significant lending transactions, including the US$9 billion financing for Zhejiang Geely Holding Group Co.'s purchase of a 9.69% stake in Daimler AG, one of the world's largest automakers. This deal makes Geely, as China's largest privately-owned automaker, the biggest shareholder in Germany's Daimler and it was voted 2018 deal of the year by China Law & Practice.

2 Guarantees

2.1 Can a company guarantee borrowings of one or more other members of its corporate group (see below for questions relating to fraudulent transfer/financial assistance)?

A company can generally guarantee borrowings of one or more other members of its corporate group. According to PRC company law, any guarantee provided by a company for a third party must be approved by its board of directors or its shareholders in accordance with the provisions of its articles of association ("**AOA**"). However, if a company guarantees the liabilities of one of its shareholders or actual controller, the guarantee must be approved by affirmative votes of more than half of the shareholders at a shareholders' meeting, excluding the shareholder whose liabilities are guaranteed.

2.2 Are there enforceability or other concerns (such as director liability) if only a disproportionately small (or no) benefit to the guaranteeing/securing company can be shown?

There are no corporate benefit rules under PRC law. Accordingly there are no enforceability or other concerns under PRC law where benefit is difficult to demonstrate, as long as that the guarantee/security is provided in accordance with the applicable PRC law as well as the AOA of the guarantor/security provider.

2.3 Is lack of corporate power an issue?

PRC company law does require appropriate corporate action to be taken to authorise the giving of a guarantee by a company for the benefit of a third party. Lenders should review a guarantor's AOA and verify that necessary corporate and shareholder authorisations are in place. It should be noticed that, according to a draft judicial interpretation by the Supreme Court of PRC (which has not been published for official implementation), a PRC court may impose stricter due diligence burden onto financial institution lenders. If the lender fails to verify the due authorisation for a guarantor to enter into a guarantee and/or security and there is a lack of due corporate authorisation, a PRC court may not support the lender's claim against the guarantor.

2.4 Are any governmental or other consents or filings, or other formalities (such as shareholder approval), required?

A guarantee/security given by an onshore company securing an obligation of an offshore borrower owing to an offshore lender may be subject to approval by or registration with the SAFE. See question 2.1 above on board and shareholder approvals. No other formalities are required for a company to grant a guarantee/security.

2.5 Are net worth, solvency or similar limitations imposed on the amount of a guarantee?

A company's AOA may limit the amount that the company can guarantee. If the guarantor is a listed company, there are additional mandatory requirements which require shareholder approval for: (1) any guarantee/security given when the aggregate amount of the external guarantee given by the listed company and its controlling subsidiary companies has exceeded 50% of the listed company's latest audited net assets; (2) any guarantee/security given to secure the obligation of a debtor whose asset to liability ratio exceeds 70%; (3) any guarantee to secure an amount exceeding 10% of the latest audited net assets of the guarantor; and (4) any guarantee provided to secure obligations of any shareholder, actual controller or their affiliated parties.

2.6 Are there any exchange control or similar obstacles to enforcement of a guarantee?

There are no exchange control or similar obstacles to enforce a guarantee so long as the giving of the guarantee complies with the regulations of the SAFE. For example, a guarantee given by a PRC company to secure the obligations of an offshore debtor owing to an offshore creditor must be registered with the SAFE within 15 business days after the date of the guarantee. The use of proceeds will also need to comply with the SAFE regulations.

3 Collateral Security

3.1 What types of collateral are available to secure lending obligations?

According to PRC law, the following collateral is available to secure lending obligations:

(1) land, buildings or other fixtures;
(2) manufacturing facilities, raw materials, semi-manufactured goods and products;
(3) transportation vessels;
(4) drafts, checks, promissory notes, bonds, deposit certificates, warehouse receipts, bills of lading;
(5) transferable shares and fund units;
(6) trademark rights, patent rights, copyright or other property rights in intellectual property that can be transferred;
(7) accounts receivable;
(8) any other property that is not prohibited by the laws;
(9) construction-in-progress; and
(10) any other property that is not prohibited by PRC law to be mortgaged, or any other rights that can be pledged as stipulated by PRC law.

3.2 Is it possible to give asset security by means of a general security agreement or is an agreement required in relation to each type of asset? Briefly, what is the procedure?

It is not possible to give asset security by means of a general security agreement, as security created over different types of assets is subject to different perfection procedures.

3.3 Can collateral security be taken over real property (land), plant, machinery and equipment? Briefly, what is the procedure?

Yes. A mortgage over real property, machinery or equipment is recognised by PRC law. Mortgages over real property need to be registered with the property bureau at the place where the property is located. Mortgages over machinery and equipment need to be registered with the State Administration for Market Regulation ("**SAMR**") at the place where the mortgagor is located. Mortgages over real property, machinery or equipment all have to be created by a written contract.

3.4 Can collateral security be taken over receivables? Briefly, what is the procedure? Are debtors required to be notified of the security?

Yes. A pledge over receivables is recognised by PRC law. The pledge has to be registered with the Credit Information Centre of the People's Bank of China ("**PBOC**"). This registration is generally done by the pledgee. The Credit Information Centre does not conduct any review or impose any other conditions. According to the PBOC regulations, receivables over which a pledge could be created must be generated from: (i) claims arising from a sale or lease, including the sale of goods, the supply of water, power, gas and heat, the licensed use of an intellectual property right, and the lease of movable properties or immovable properties; (ii) claims arising from the provision of services in areas of medical care, education, tourism, labour or other services; (iii) the right to obtain profits from energy, transport, water conservancy, environmental protection, municipal projects and other infrastructure and public utility projects; (iv) claims arising from the provision of loans or other credit activities; and (v) other rights entitled by the right holder under the law to claim payments. PRC law does not require notice of the security to be given to the debtor. However, it is good practice for notice to be given.

3.5 Can collateral security be taken over cash deposited in bank accounts? Briefly, what is the procedure?

Yes. A pledge over a cash deposit is recognised by PRC law. To create a pledge over a cash deposit, cash in the bank account must be ascertained and identified at the time of the creation of the pledge. The general understanding is that the bank account balance must not change. However there has been a recent court case indicating that fluctuation in the bank account balance may be permitted under certain circumstances.

3.6 Can collateral security be taken over shares in companies incorporated in your jurisdiction? Are the shares in certificated form? Can such security validly be granted under a New York or English law governed document? Briefly, what is the procedure?

Yes. A pledge of shares can be created over shares in companies incorporated in China. The documents granting security over the shares must be governed by PRC law. If not, the security interest would not be enforceable in China. The procedures to create a pledge of shares differ depending on the type of company. In the case of shares of a listed company, the pledge must be registered with the China Securities Deposit and Clearing Corporation Limited. In the case of shares of a foreign invested enterprise ("**FIE**"), the pledge is subject to approval from or online filing with the Ministry of Commerce or its local branch ("**MOFCOM**"), as the case may be, depending on whether such FIE's business scope falls into the catalogue of encouraged/permitted industries for foreign investment or restricted industries for foreign investment (approval from MOFCOM may be required if the FIE falls into a restricted category). In the case of shares of a non-listed and non-FIE company, the pledge must be registered with local SAMR where the company whose shares are being pledged is registered.

3.7 Can security be taken over inventory? Briefly, what is the procedure?

Yes. PRC property law provides that a party may create a mortgage over manufacturing equipment, raw materials, semi-finished products and finished products owned by it at the present or in the future. This is a concept similar to the concept of a floating charge under the common law. The mortgage must be in writing and registered with the SAMR. Without SAMR registration, the claim of the mortgagee is vulnerable to third party claims.

3.8 Can a company grant a security interest in order to secure its obligations (i) as a borrower under a credit facility, and (ii) as a guarantor of the obligations of other borrowers and/or guarantors of obligations under a credit facility (see below for questions relating to the giving of guarantees and financial assistance)?

Yes. The conditions outlined in questions 2.1 and 2.6 also apply here.

3.9 What are the notarisation, registration, stamp duty and other fees (whether related to property value or otherwise) in relation to security over different types of assets?

Generally, no notarisation or stamp duty is required for creating security over different types of assets. If a security document involves a non-PRC party, notarisation by a notary and legalisation by a Chinese embassy or consulate may be required. In respect of registration requirements, see questions 3.3 to 3.7. Registration fees may be charged depending on the types of assets but the fees are mostly nominal.

3.10 Do the filing, notification or registration requirements in relation to security over different types of assets involve a significant amount of time or expense?

Timing for security perfection varies depending on the type of security. For example, perfection of a pledge of shares of an FIE requires online filing with or approval from (as the case may be) MOFCOM and SAMR registration. The approval from MOFCOM normally takes a couple of months while online filing and SAMR registration may take a couple of weeks. A mortgage of equipment or property on the other hand can take a considerable period of time. When a foreign party is involved, notarisation and legalisation may be required, in which case, the security perfection process is longer. Other than registration fees there are no other governmental charges in respect of the creation of security.

3.11 Are any regulatory or similar consents required with respect to the creation of security?

There are no regulatory or similar consents required with respect to the creation of security except for the limited circumstances discussed in questions 2.6 and 3.6.

3.12 If the borrowings to be secured are under a revolving credit facility, are there any special priority or other concerns?

If the borrowings to be secured are under a revolving credit facility, usually a "maximum amount security" will need to be used. Under PRC law, a maximum amount security refers to a security created to secure obligations incurred during a period of time and the aggregate secured amount is subject to a maximum cap agreed by the parties. When applying a maximum amount security under a revolving credit facility it is necessary for the lender to calculate the maximum loan amount and the interest with a cushion.

3.13 Are there particular documentary or execution requirements (notarisation, execution under power of attorney, counterparts, deeds)?

If a PRC law governed contract requires both signing and affixing of a company chop, due execution of the contract requires both signing by authorised signatory(ies) as well as affixing of the company chop. If a contract does not require both signing and affixing of a company chop, either signing by authorised signatory(ies) or affixing a company chop would be considered as due execution of the contract. A company is bound by execution by its legal representative. There are no special requirements on notarisation, execution under power of attorney, counterparts or deeds by a PRC party. If a signing party is a non-PRC party, notarisation and legalisation may be required in respect of the non-PRC party's execution of the relevant security documents.

4 Financial Assistance

4.1 Are there prohibitions or restrictions on the ability of a company to guarantee and/or give security to support borrowings incurred to finance or refinance the direct or indirect acquisition of: (a) shares of the company; (b) shares of any company which directly or indirectly owns shares in the company; or (c) shares in a sister subsidiary?

There is no general prohibition on financial assistance. However, the restrictions on granting of a guarantee outlined in question 2.1 also apply to the grant of security. Where a loan is extended from an offshore lender to an offshore borrower supported by a security and/or guarantee given by a PRC company to finance or refinance an offshore acquisition, SAFE regulations require that PRC outbound investment procedures are to be duly complied with.

5 Syndicated Lending/Agency/Trustee/Transfers

5.1 Will your jurisdiction recognise the role of an agent or trustee and allow the agent or trustee (rather than each lender acting separately) to enforce the loan documentation and collateral security and to apply the proceeds from the collateral to the claims of all the lenders?

The role of agent for a syndicate of banks who may change from time to time is recognised under PRC law. Trustees are not generally used in the context of syndicated lending in China. It is usual for syndicated loan lenders to appoint a facility agent or security agent to act for and on behalf of the syndicate. Subject to the provisions of the transaction documents, the agent bank may claim the whole amount of the loan from the obligors and distribute the proceeds to the syndicate banks in accordance with the provisions of the transaction documents.

5.2 If an agent or trustee is not recognised in your jurisdiction, is an alternative mechanism available to achieve the effect referred to above which would allow one party to enforce claims on behalf of all the lenders so that individual lenders do not need to enforce their security separately?

This is not applicable in the PRC.

5.3 Assume a loan is made to a company organised under the laws of your jurisdiction and guaranteed by a guarantor organised under the laws of your jurisdiction. If such loan is transferred by Lender A to Lender B, are there any special requirements necessary to make the loan and guarantee enforceable by Lender B?

According to PRC contract law, a party to a contract may transfer its rights to a third party by notifying the obligor of the transfer of the contractual rights and a party to a contract may assign its obligations after getting consent from the obligee, unless otherwise agreed in a contract. Accordingly, unless the loan agreement provides otherwise, Lender A may transfer its right to a loan already disbursed to the borrower by giving notice to the borrower. If a loan is yet to be disbursed, Lender A may only assign the obligation to disburse a loan if the borrower's consent is obtained. The notice or the consent must be in writing. No consent is required from a guarantor for the transfer or assignment of the loan from Lender A to Lender B unless the guarantee document expressly required this. It is good practice to notify the guarantor of the transfer or assignment.

6 Withholding, Stamp and Other Taxes; Notarial and Other Costs

6.1 Are there any requirements to deduct or withhold tax from (a) interest payable on loans made to domestic or foreign lenders, or (b) the proceeds of a claim under a guarantee or the proceeds of enforcing security?

Income received by a lender from loans extended by it to a PRC borrower will be subject to PRC income tax. Such income may include (a) interest received by it on the loans, and (b) the proceeds of a claim under a guarantee or of enforcing security which constitutes payment of interest. For a PRC onshore lender in general the income tax rate is 25% of its annual net profit. Tax payable by an offshore lender will be withheld from the PRC obligor's payment – the usual rate is 10% income tax and 6% value added tax on the interest amount, but preferential rates may be applied depending on the applicable tax treaty.

6.2 What tax incentives or other incentives are provided preferentially to foreign lenders? What taxes apply to foreign lenders with respect to their loans, mortgages or other security documents, either for the purposes of effectiveness or registration?

There are no preferential tax incentives or other incentives provided specifically to foreign lenders, except that foreign lenders may enjoy a preferential income tax rate provided by the applicable tax treaty between the PRC government and the government of the offshore lender's place of business. As of the end of December 2018, the PRC government has entered into tax treaties with 107 jurisdictions, and Hong Kong and Macau Special Administrative Regions, of which 100 have come into force. In addition to income tax, stamp duty is payable at 0.05% of the loan amount by both the lender and the borrower respectively. A lender will also be subject to a business tax. Apart from these, there is no other tax in relation to a loan transaction.

6.3 Will any income of a foreign lender become taxable in your jurisdiction solely because of a loan to, or guarantee and/or grant of, security from a company in your jurisdiction?

See question 6.1 above. A foreign lender may be subject to income tax and value-added tax with respect to income received by it from loans provided to a PRC obligor.

6.4 Will there be any other significant costs which would be incurred by foreign lenders in the grant of such loan/guarantee/security, such as notarial fees, etc.?

Except for stamp duty, registration fees (e.g. for mortgage registration) and notary costs (if applicable), there are no other government fees or costs.

6.5 Are there any adverse consequences for a company that is a borrower (such as under thin capitalisation principles) if some or all of the lenders are organised under the laws of a jurisdiction other than your own? Please disregard withholding tax concerns for purposes of this question.

If some or all of the lenders are foreign lenders, the loan made to PRC companies is considered as foreign debt. There are restrictions as to whether a company could borrow foreign debt and how much it can borrow. Treatment is different for a FIE in China or non-FIE. FIE and non-FIE companies may carry out cross-border financing in RMB or foreign currencies in accordance with the Circular on the Matters Relating to the *Macro-prudential Management of Full-covered Cross-border Financing* ("**Circular 9**"), whilst a FIE may choose between the regulation regime under Circular 9 and its existing foreign debt management system.

7 Judicial Enforcement

7.1 Will the courts in your jurisdiction recognise a governing law in a contract that is the law of another jurisdiction (a "foreign governing law")? Will courts in your jurisdiction enforce a contract that has a foreign governing law?

The PRC courts will recognise and enforce a governing law in a contract that is the law of another jurisdiction if there is a foreign element in connection with the contract; for example, if one of the parties to the contract is a foreign party or if the subject matter is located outside of China. The choice of foreign governing law must not violate China's social public interest.

7.2 Will the courts in your jurisdiction recognise and enforce a judgment given against a company in New York courts or English courts (a "foreign judgment") without re-examination of the merits of the case?

A judgment rendered by a New York court or English court is currently not enforceable in China. This is because a PRC court will only recognise and enforce a foreign court judgment if (a) a bilateral judicial assistance treaty exists between China and the country of the foreign court, (b) both countries have joined an international convention on recognising and enforcing foreign court judgments or written orders, or (c) precedents of reciprocity exist. There is no reciprocal recognition or enforcement of judgments or written order between China and the UK or the US.

7.3 Assuming a company is in payment default under a loan agreement or a guarantee agreement and has no legal defence to payment, approximately how long would it take for a foreign lender to (a) assuming the answer to question 7.1 is yes, file a suit against the company in a court in your jurisdiction, obtain a judgment, and enforce the judgment against the assets of the company, and (b) assuming the answer to question 7.2 is yes, enforce a foreign judgment in a court in your jurisdiction against the assets of the company?

A foreign lender may immediately file a suit against the company as soon as all the required court papers are in order. It will generally take up to six months to obtain a first instance judgment which shall be final if no party makes an appeal. If either party makes an appeal to a second instance court, it will generally take up to three months to obtain a second instance judgment, which shall be the final judgment. It is difficult to predict how long it will take to enforce the judgment.

7.4 With respect to enforcing collateral security, are there any significant restrictions which may impact the timing and value of enforcement, such as (a) a requirement for a public auction, or (b) regulatory consents?

Enforcement of security could be either on a consensual basis, i.e. the creditor and the security provider agree on the realisation of the collateral by conversion to value, or the creditor and security provider arrange auction or sale without going to the court. If the security provider is not cooperative, the creditor will need to bring proceedings in a competent PRC court seeking a judgment. If a favourable judgment is rendered, the creditor may commence an enforcement proceeding during which the collateral could be auctioned or sold at the oversight of the court. Consents from government bodies are generally not required unless state-owned assets or FIE shares are involved.

7.5 Do restrictions apply to foreign lenders in the event of (a) filing suit against a company in your jurisdiction, or (b) foreclosure on collateral security?

The fact that a lender is foreign does not in itself impose additional restrictions on enforcing a loan or security.

7.6 Do the bankruptcy, reorganisation or similar laws in your jurisdiction provide for any kind of moratorium on enforcement of lender claims? If so, does the moratorium apply to the enforcement of collateral security?

After a Chinese court accepts a bankruptcy application, any preservation measure in respect of the bankrupt debtor's assets shall be released and any enforcement proceeding shall be suspended. Further, pending civil proceedings or arbitrations relating to the bankrupt debtor shall also be suspended and such proceedings may resume after the administrator has taken over the assets of the bankrupt debtor.

7.7 Will the courts in your jurisdiction recognise and enforce an arbitral award given against the company without re-examination of the merits?

Chinese courts will not examine the substance of the arbitral award given by a foreign arbitration tribunal and will give effect to and enforce the award provided that it is in compliance with the New York Convention.

8 Bankruptcy Proceedings

8.1 How does a bankruptcy proceeding in respect of a company affect the ability of a lender to enforce its rights as a secured party over the collateral security?

According to PRC Bankruptcy Law, once a PRC court accepts an application for bankruptcy petition in relation to a bankrupt debtor, both secured creditors and unsecured creditors will need to declare their claims to the administrator for such claims to be registered. All creditors can then participate in the distribution of the assets of the bankrupt debtor.

8.2 Are there any preference periods, clawback rights or other preferential creditors' rights (e.g., tax debts, employees' claims) with respect to the security?

In order to protect the interests of the creditors and the equity-owners of the debtor, the PRC Bankruptcy Law allows the administrator to petition the court to invalidate certain types of transactions conducted by the debtor within one year before the court accepts the bankruptcy petition, and to clawback the relevant assets back into the debtor's assets pool for subsequent distribution to the creditors and the equity-owners: (1) transfers of assets without consideration; (2) trading at an obviously unreasonable price; (3) providing assets-based security for debts not secured by property; (4) paying off undue debts in advance; or (5) giving up its right as a creditor.

The administrator may also petition the court to clawback payment made by the bankrupt debtor to certain creditors within six months before the court accepts the bankruptcy petition, provided that at the time of the payment the bankrupt debtor was insolvent.

The secured creditor's rights rank behind any outstanding salaries, pensions for the disabled, basic pension insurance, basic medical insurance or other compensation incurred before 27 August 2006 (the date on which the PRC Bankruptcy Law was adopted and promulgated) and payable to the employees of the bankrupt debtor according to relevant laws and regulations. These employees' claims, if incurred after 27 August 2006, will rank behind the secured creditor's secured obligations. In addition, if the security is created after incurring overdue tax payment, the tax payment shall rank ahead of the security.

8.3 Are there any entities that are excluded from bankruptcy proceedings and, if so, what is the applicable legislation?

PRC Bankruptcy Law applies to PRC companies in general, but does not apply to PRC financial institutions. The bankruptcy proceedings of financial institutions shall be governed by rules which are yet to be promulgated by the State Council.

8.4 Are there any processes other than court proceedings that are available to a creditor to seize the assets of a company in an enforcement?

No, seizure of assets of a company in an enforcement scenario may only occur following court proceedings.

9 Jurisdiction and Waiver of Immunity

9.1 Is a party's submission to a foreign jurisdiction legally binding and enforceable under the laws of your jurisdiction?

If a contract has no foreign elements, the subject matter shall be deemed as in the exclusive jurisdiction of the Chinese courts. The submission to a foreign jurisdiction shall be valid under PRC law if the subject matter is not under the exclusive jurisdiction of the PRC courts. As for the enforcement of a judgment made in a foreign jurisdiction, it depends on the applicable bilateral treaties, or otherwise on the basis of reciprocity.

9.2 Is a party's waiver of sovereign immunity legally binding and enforceable under the laws of your jurisdiction?

China adopts the "absolute immunity" principle, which provides complete immunity to the sovereign state. Therefore, any waiver of sovereign immunity is not legally binding and not enforceable if it is made by a Chinese governmental body. Please note, however, that state-owned enterprises are considered as separate legal entities rather than Chinese government bodies and therefore sovereign immunity does not apply to state-owned enterprises.

10 Licensing

10.1 What are the licensing and other eligibility requirements in your jurisdiction for lenders to a company in your jurisdiction, if any? Are these licensing and eligibility requirements different for a "foreign" lender (i.e. a lender that is not located in your jurisdiction)? In connection with any such requirements, is a distinction made under the laws of your jurisdiction between a lender that is a bank *versus* a lender that is a non-bank? If there are such requirements in your jurisdiction, what are the consequences for a lender that has not satisfied such requirements but has nonetheless made a loan to a company in your jurisdiction? What are the licensing and other eligibility requirements in your jurisdiction for an agent under a syndicated facility for lenders to a company in your jurisdiction?

Only financial institutions or quasi-financial institutions with lending as one of its approved business activities (e.g. banks, trust companies, auto-financial companies, micro-lending companies) can engage in the lending business. A foreign lender who makes a loan to a PRC company cross-border is not required to be licensed, qualified or otherwise entitled to carry on business in the PRC. A lender which carries out a lending business without lending as its approved business scope will be deemed to be carrying on illegal financial services and be sanctioned accordingly. In China, it is usual for a facility and security agent under a syndicated facility to also be a syndicate lender. A foreign lender can be an agent without any licence in the PRC.

11 Other Matters

11.1 Are there any other material considerations which should be taken into account by lenders when participating in financings in your jurisdiction?

It is worth noting that when non-bank entities are acting as guarantor/ security providers in offshore financing transactions, domestic enterprises and overseas banks must also pay close attention to the requirements imposed by the SAFE and other PRC regulators in relation to cross-border guarantee/security in such cases, to ensure the compliance of such transactions.

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Stanley Zhou specialises in general banking, structured financing, property financing, financial regulation and compliance, financial institutions Internet-financing, financial lease, commercial factoring.

Stanley has extensive experience in banking and finance and provides legal advice to domestic and international banks and other financial institutions in a variety of matters, including set-up, merger and acquisition of financial institutions, syndicated loans, property finance, cross-border RMB trade, pre-IPO finance, privatisation finance and other cross-border transactions, and providing regulatory advices in relation to their business, operation and marketing activities in China. Stanley also advises borrowers and other corporate clients in their receiving various financial services from banks and other financial institutions, including borrowing, derivative transactions, structured products and wealth management. Stanley is very familiar with Shanghai Pilot Free Trade Zone, advising plenty of financial institutions and corporations in the FTZ on their cross-border transactions.

Stanley also has strong expertise in bank card industry, payment service institutions and payment business, pre-paid card and internet-financing.

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Stanley graduated from the Law School of Fudan University and qualified in the same year.

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Areas of Practice

Jack Wang is in charge of the firm's US offices, and specialises in international finance, project finance, foreign direct investment, and mergers and acquisitions.

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Jack has handled many large transactions in industries such as power, petrochemicals, expressways, water plants, bridges, aluminium plants, and MTR. He has also represented various international companies in their incorporation of foreign-invested enterprises or acquisitions of domestic companies.

Work Experience

Jack joined King & Wood Mallesons in 2003. Prior to joining King & Wood Mallesons, Jack was in charge of the Department of International Finance, at the Global Law Office in Beijing. He has also practised law at the New York office of Sherman & Sterling and at the Hong Kong office of Linklaters.

He graduated from Jilin University and earned his J.D. at Emory University in the United States.

Jack is qualified to practise law in China and in New York State.

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- Corporate & Finance China Law Firm of the Year, *Chambers China Awards, 2019.*
- Banking and Finance China Firm of the Year, *Asian-Mena Counsel, 2018.*
- Banking & Finance Firm of the Year, *China Law & Practice Awards, 2017 & 2018.*
- Asia Pacific Law Firm of the Year, *Chambers Asia-Pacific Awards, 2018.*
- Law Firm of the Year – Banking & Finance, *Best Lawyers 2018*.
- Law Firm of the Year – *KangaNews Awards 2018* (12 consecutive years).
- Best Law Firm (revenue over $200m) AFR Client Choice 2018 (3 consecutive years) and Best Professional Services Firm (over $200m) *AFR Client Choice 2016* and *2018*.

Chapter 43

Colombia

Santiago Gutiérrez

Juan Sebastián Peredo

Lloreda Camacho & Co.

1 Overview

1.1 What are the main trends/significant developments in the lending markets in your jurisdiction?

The Colombian market is trending towards fintech models. Digital lending models and crowdfunding have been growing exponentially. Colombia has seen an active development of regulation and legislation aimed at including new players, models and infrastructure in the financial system. This active approach from the Colombian financial regulator has led to the analysis of innovative models brought by fintech companies, both locally and internationally. Colombia is currently third in Latin American countries with the most fintech developments, behind only Brazil and Mexico.

Given the economic scenario, we believe that the Colombian lending market will continue to implement fintech models, traditional credit structures and traditional credit products, as well as new, different structures that will arise from debt restructuring.

1.2 What are some significant lending transactions that have taken place in your jurisdiction in recent years?

Colombia continues to be a country where relevant lending transactions have been completed. Recently, the country has faced an increasing number of transactions related to infrastructure in Colombia, as well as corporate finance.

Some significant transactions in which Lloreda Camacho has participated are: (i) a pre-export finance facility granted by Société Génerale to Prodeco CI, acting as a borrower; (ii) a facility granted by Standard Chartered to Petrominerales Colombia Ltda; (iii) a facility granted by the Interamerican Development Bank to Grupo la Hipotecaria in Colombia, Salvador and Panama; (iv) a syndicated loan granted by the Toronto-Dominion Bank and a syndicate of lenders in order to finance Enerflex, a Colombian company; and (v) a syndicated loan granted by Bancolombia to Phoenix Group – Multidimensionales.

2 Guarantees

2.1 Can a company guarantee borrowings of one or more other members of its corporate group (see below for questions relating to fraudulent transfer/financial assistance)?

Companies in Colombia are permitted to guarantee borrowing of members of their corporate group, so long as their by-laws contemplate such a possibility. The guarantor must have included this activity within its corporate purpose.

2.2 Are there enforceability or other concerns (such as director liability) if only a disproportionately small (or no) benefit to the guaranteeing/securing company can be shown?

Directors of Colombian companies are subject to certain fiduciary duties. Directors, therefore, have to act in good faith, loyalty and with the diligence of a good business man (article 23 of Law 222 of 1995). Directors' actions must be fulfilled in the interest of the company, taking into account the interests of the shareholders. Directors are jointly and unlimitedly liable for any damages that they may cause due to their own fault or wrongdoing to the company, the shareholders and third parties (article 200 of the Colombian Commerce Code).

Therefore, directors must ensure that the transaction (guaranteeing/securing) is included in the corporate purpose of the company and that such transaction does not infringe any of the duties described above.

2.3 Is lack of corporate power an issue?

A contract may be declared annulled in the event that the legal representative of the company (i.e. the director acting on behalf of the company) exceeded his or her faculties as established in the by-laws. Such annulment must be declared by a court in Colombia.

2.4 Are any governmental or other consents or filings, or other formalities (such as shareholder approval), required?

Corporate by-laws may require that certain transactions, such as guaranteeing/securing other companies' debt, or transactions that exceed a certain threshold, must be approved by either the Board of Directors or the General Shareholders' Assembly of the company.

2.5 Are net worth, solvency or similar limitations imposed on the amount of a guarantee?

Neither net worth nor solvency are criteria that impose limits on the amount of a guarantee.

2.6 Are there any exchange control or similar obstacles to enforcement of a guarantee?

Colombia's foreign exchange regime provides for certain registration rules applicable when Colombian companies guarantee borrowings of companies abroad or when foreign companies guarantee transactions in Colombia or with Colombian residents. These registration requirements do not constitute an obstacle to the enforcement of a guarantee.

3 Collateral Security

3.1 What types of collateral are available to secure lending obligations?

Collateral can traditionally be taken over real property and movable assets. The mechanisms to secure these assets, as explained further below, are traditionally through a mortgage agreement (real property), a pledge agreement (movable assets) or trust agreement (both real property and movable assets).

3.2 Is it possible to give asset security by means of a general security agreement or is an agreement required in relation to each type of asset? Briefly, what is the procedure?

A general security agreement would be permitted for purposes of taking security, as long as each asset that is being granted in security is identified in the agreement. With regard to real property security, a different agreement would be necessary, taking into account the procedure to take such type of asset as collateral (please refer to question 3.3 below).

3.3 Can collateral security be taken over real property (land), plant, machinery and equipment? Briefly, what is the procedure?

Collateral security can be taken over a variety of assets. The procedure varies if the asset is considered real property or movable. In the case of movable assets, collateral security would be taken through a pledge agreement which would have to be registered with the Movable Assets Collateral Registry (*Registro de Garantías Mobiliarias*). In the case of real property, the collateral security would have to be taken through a mortgage agreement (through a public deed) which would have to be registered with the Public Instruments Office (*Oficina de Registro de Instrumentos Públicos*).

3.4 Can collateral security be taken over receivables? Briefly, what is the procedure? Are debtors required to be notified of the security?

Yes. Receivables can be taken as collateral security. As a general principle, the debtors of the receivables would not have to be notified. However, the grantor of the collateral must follow any particular agreements reached with the debtor regarding notification of the security.

3.5 Can collateral security be taken over cash deposited in bank accounts? Briefly, what is the procedure?

Yes. Colombia permits taking collateral security over cash deposited in bank accounts. The procedure to secure the funds in bank accounts varies if the secured party is the bank where the cash is deposited or if the secured party is not the bank. In case the secured party is the bank, the collateral security would be completed by the execution of a security agreement whereby the bank, as the secured party, would have possession of the cash. In case the secured party is not the bank, a tri-party control agreement over the bank account would have to be executed.

3.6 Can collateral security be taken over shares in companies incorporated in your jurisdiction? Are the shares in certificated form? Can such security validly be granted under a New York or English law governed document? Briefly, what is the procedure?

Yes. Collateral security can be taken over shares of Colombian companies. Law 1676 of 2013 provides for the procedure applicable for granting shares (in certificated form) as collateral security pledges. For this purpose: (i) a pledge agreement over the shares would have to be executed; (ii) the pledge would have to be registered in the stock ledger of the company; and (iii) the pledge would have to be registered with the Public Instruments Office (*Oficina de Registro de Instrumentos Públicos*). The collateral documents must be governed by Colombian law.

3.7 Can security be taken over inventory? Briefly, what is the procedure?

Yes. Inventories are considered movable assets subject to Law 1676 of 2013. Therefore, security can be taken over this type of asset, subject to complying with the registration requirements set forth in the aforementioned law.

3.8 Can a company grant a security interest in order to secure its obligations (i) as a borrower under a credit facility, and (ii) as a guarantor of the obligations of other borrowers and/or guarantors of obligations under a credit facility (see below for questions relating to the giving of guarantees and financial assistance)?

A company in Colombia can grant a security interest to either secure its obligations as a borrower or as a guarantor of other borrowers under a credit facility. With regard to granting security as a guarantor, please refer to our answers to questions 2.6 and 4.1.

3.9 What are the notarisation, registration, stamp duty and other fees (whether related to property value or otherwise) in relation to security over different types of assets?

Costs related to notarisation, registration and other fees vary from each type of security. In relation to a mortgage (real property), the following cost will arise:

(i) Notarisation fees.

(ii) Registration tax.

(iii) Registration rights.

In relation to security interests over movable assets (*garantías mobiliarias*), a registry tax must be paid to Confecámaras (the chambers of commerce association) for an amount equivalent to USD$15.

In relation to a security trust agreement, aside from the costs that may arise from transferring the asset to the trust and the costs related to the registration of such transfer and of the trust agreement as a security, the trust company (*sociedad fiduciaria*) will charge fees for the administration of the trust.

3.10 Do the filing, notification or registration requirements in relation to security over different types of assets involve a significant amount of time or expense?

With regard to collateral security taken over movable assets, filing, notification and registrations does not involve a significant amount of time and can be completed in one day (the procedure for registration is carried out through the website of the *Registro de Garantías Mobiliarias*).

With regard to real property security, the procedure would involve granting the security through a mortgage public deed and registering the security with the Public Instruments Office. This procedure can take between one and two weeks.

Finally, in relation to security granted under the trust agreement, time and expense will depend on the type of asset taken as security. The time and costs will depend on the procedure that must be followed to transfer the assets to the trust.

3.11 Are any regulatory or similar consents required with respect to the creation of security?

As a general rule, the creation of security does not depend on regulatory consents. Nevertheless, the applicable regime of certain entities may provide for particular authorisations when granting collateral security.

3.12 If the borrowings to be secured are under a revolving credit facility, are there any special priority or other concerns?

There are no special priority concerns.

3.13 Are there particular documentary or execution requirements (notarisation, execution under power of attorney, counterparts, deeds)?

Please refer to our answers to questions 3.9 and 3.10.

4 Financial Assistance

4.1 Are there prohibitions or restrictions on the ability of a company to guarantee and/or give security to support borrowings incurred to finance or refinance the direct or indirect acquisition of: (a) shares of the company; (b) shares of any company which directly or indirectly owns shares in the company; or (c) shares in a sister subsidiary?

(a) Shares of the company

There is no general prohibition for companies to use financial assistance in the acquisition of shares, except for financial services. Colombian law prohibits credit institutions, including banks and insurance companies, to lend funds to third parties in order to acquire shares or mandatorily convertible bonds of the lending bank, its affiliates or any financial institution in Colombia, unless the acquisition refers to a primary issuance of shares or a privatisation process.

Therefore, there is no general prohibition on the ability to guarantee or give security to support borrowing incurred to finance or refinance the acquisition of shares.

Banks are allowed to lend funds to third parties in order to acquire the control of companies other than financial institutions.

(b) Shares of any company which directly or indirectly owns shares in the company

There is no general prohibition for the acquisition of shares under this scenario (please refer to the limitations for credit institutions). Regarding the acquisition of shares of a parent company, article 232 of the Colombian Commerce Code establishes that a subordinated company shall not hold shares of the parent company that controls it, and that any agreement contrary to such provision shall be considered null and void.

(c) Shares in a sister subsidiary

There is no general prohibition for the acquisition of shares under this scenario (please refer to the limitations for credit institutions).

5 Syndicated Lending/Agency/Trustee/Transfers

5.1 Will your jurisdiction recognise the role of an agent or trustee and allow the agent or trustee (rather than each lender acting separately) to enforce the loan documentation and collateral security and to apply the proceeds from the collateral to the claims of all the lenders?

Yes. In Colombia, the role of an agent or a trustee is recognised. This recognition permits the agent to enforce the loan documentation and collateral security (being the "secured party") and apply the proceeds to the claims of all the lenders. This is true from the perspective of foreign indebtedness (where the loan is subject to foreign law) or local indebtedness (using similar legal structures that resemble an agent or trustee).

5.2 If an agent or trustee is not recognised in your jurisdiction, is an alternative mechanism available to achieve the effect referred to above which would allow one party to enforce claims on behalf of all the lenders so that individual lenders do not need to enforce their security separately?

The role of an agent or trustee is recognised in Colombia.

5.3 Assume a loan is made to a company organised under the laws of your jurisdiction and guaranteed by a guarantor organised under the laws of your jurisdiction. If such loan is transferred by Lender A to Lender B, are there any special requirements necessary to make the loan and guarantee enforceable by Lender B?

There are no special requirements for debt transfer in Colombia, except as otherwise provided in the relevant debt documents. The particular lending and security instruments would have to be assigned or novated. The collateral security registrations would have to be updated in order to reflect the new lender in the registry. If the transaction is a foreign loan, the foreign indebtedness registration with the Colombian Central Bank must be updated.

6 Withholding, Stamp and Other Taxes; Notarial and Other Costs

6.1 Are there any requirements to deduct or withhold tax from (a) interest payable on loans made to domestic or foreign lenders, or (b) the proceeds of a claim under a guarantee or the proceeds of enforcing security?

(a) As a general rule, interest is a deductible expense for income tax purposes. Article 107 of the Colombian Tax Code allows such deduction as long as the following conditions are fulfilled: (i) interest must be related to the income-producing activity; (ii) it must be necessary; and (iii) it must be reasonable to carry out income-producing activity.

Interest deductibility for income tax purposes is subject to further limitations:

(i) Deduction on interest expenses shall not exceed the highest interest rate authorised by the Superintendence of Finance.

(ii) The inflationary component of interest is not treated as a deductible expense.

(iii) In accordance with the Thin Capitalization Rule (article 118-1 of the Colombian Tax Code), interest accrued on debts or liabilities, the amount of which exceeds the taxpayer's equity by three times, is not deductible.

(iv) Deduction of payments made abroad (interest included) is limited to an amount equal to 15% of the annual taxable income, unless a withholding tax is triggered by the Colombian debtor.

(v) Interest payments to non-residents are subject to an income withholding tax at a tax rate of 15%.

(vi) Interest expenses to related parties are not deductible, except: (i) short-term debt (less than 12 months) for the acquisition of raw materials or merchandise; or (ii) related parties that have complied with transfer pricing regulations. Presumptive interest shall be accrued if the lender is a shareholder of the borrower.

(b) The proceeds of a claim under a guarantee or the proceeds of enforcing security are not subject to income tax consequences, as long as payments under such procedures are treated as principal. For payments treated as interest, the abovementioned provisions apply.

6.2 What tax incentives or other incentives are provided preferentially to foreign lenders? What taxes apply to foreign lenders with respect to their loans, mortgages or other security documents, either for the purposes of effectiveness or registration?

Colombian tax legislation does not provide any special incentive to foreign lenders, unless a tax treaty applies. Interest income accrued or paid abroad is subject to income withholding tax. If such withholding is triggered and paid, foreign lenders are not obliged to file an income tax return in Colombia. A general income withholding tax rate applies on interest payments if the lender is located in a jurisdiction listed as a tax haven by the Colombian Government.

6.3 Will any income of a foreign lender become taxable in your jurisdiction solely because of a loan to, or guarantee and/or grant of, security from a company in your jurisdiction?

Yes. In cross-border loan relationships, interest payments from a Colombian borrower are treated as Colombian-source income and hence subject to taxation in Colombia.

6.4 Will there be any other significant costs which would be incurred by foreign lenders in the grant of such loan/guarantee/security, such as notarial fees, etc.?

There are no other significant costs. Please refer to our answer to question 3.9.

6.5 Are there any adverse consequences for a company that is a borrower (such as under thin capitalisation principles) if some or all of the lenders are organised under the laws of a jurisdiction other than your own? Please disregard withholding tax concerns for purposes of this question.

No. We do not identify adverse consequences. Nevertheless, please refer to our taxation comments in our answer to question 6.1 above (with regard to thin capitalisation, please refer to question 6.1 (a) (iii)).

7 Judicial Enforcement

7.1 Will the courts in your jurisdiction recognise a governing law in a contract that is the law of another jurisdiction (a "foreign governing law")? Will courts in your jurisdiction enforce a contract that has a foreign governing law?

Pursuant to Colombian law, it is possible to agree on foreign governing law and jurisdiction, whenever it is considered that the contract is performed abroad (or substantially performed abroad). This is the case with foreign loans. However, agreeing on foreign law and submitting the contract to local jurisdiction may entail significant difficulties, in terms of applying and proving the foreign law before local courts.

7.2 Will the courts in your jurisdiction recognise and enforce a judgment given against a company in New York courts or English courts (a "foreign judgment") without re-examination of the merits of the case?

Yes, courts in Colombia would recognise and enforce a foreign judgment. In order for foreign judgments to have the same enforceability as a local judgment, they should be first recognised by the Supreme Court of Justice, prior to being submitted for collection proceedings. This process is known as *exequatur*.

Exequatur shall be commenced before the Supreme Court of Justice in order to validate the foreign judgment if it complies with the following requirements established in article 606 of the Colombian General Process Code: (i) the judgment does not relate to "*in rem*" rights vested in assets that were located in Colombia at the time the proceeding was commenced; (ii) it does not contravene any laws deemed to be "public policy laws"; (iii) it is executed accordingly with the law of the country of origin, and it is presented as a duly legalised copy; (iv) it is a final award not subject to further challenges; (v) it does not refer to any matter upon which Colombian courts have exclusive jurisdiction; and (vi) it does not refer to a matter under pending litigation in Colombia or already ruled upon in Colombia. *Exequatur* also depends on diplomatic reciprocity. Once *exequatur* is granted, the interested party shall commence collection proceedings.

7.3 Assuming a company is in payment default under a loan agreement or a guarantee agreement and has no legal defence to payment, approximately how long would it take for a foreign lender to (a) assuming the answer to question 7.1 is yes, file a suit against the company in a court in your jurisdiction, obtain a judgment, and enforce the judgment against the assets of the company, and (b) assuming the answer to question 7.2 is yes, enforce a foreign judgment in a court in your jurisdiction against the assets of the company?

Filing a suit against a company in a court under Colombian jurisdiction may take approximately one to three weeks. Then, obtaining a first instance judgment may take approximately a year-and-a-half to two years, and a second instance ruling, if applicable, may take approximately six months to one year. Please bear in mind that agreeing on foreign law and submitting the contract to local jurisdiction may entail significant difficulties, in terms of applying and proving the foreign law before local courts.

For the enforcement of a foreign judgment in a court in Colombia against the assets of a company, as mentioned in our answer to question 7.2, the Supreme Court has to recognise the judgment as a valid and enforceable decision under the *exequatur* proceeding. This proceeding may take from six months to one year. Once the foreign judgment is recognised, it would be considered an executive title. In order to enforce such title, a collection proceeding should be initiated. The duration of this proceeding may last around six months.

7.4 With respect to enforcing collateral security, are there any significant restrictions which may impact the timing and value of enforcement, such as (a) a requirement for a public auction, or (b) regulatory consents?

Mortgages require completing a court-mandated auction. The proceeds from such court-mandated auction would be delivered to the secured party. In case the auction is unsuccessful, the collateral would be delivered to the secured party.

In relation to pledges over movable assets, governed by Law 1676 of 2013, creditors may be entitled to directly claim or acquire property over pledged collateral through a direct payment mechanism, by a special execution of the collateral or by a judicial proceeding. This makes collateral over movable assets more efficient in terms of timing and value of enforcement.

7.5 Do restrictions apply to foreign lenders in the event of (a) filing suit against a company in your jurisdiction, or (b) foreclosure on collateral security?

No, there are no restrictions that exclusively apply to foreign lenders in the event of filing a suit against a company in Colombia, nor in the event of foreclosure on collateral security.

7.6 Do the bankruptcy, reorganisation or similar laws in your jurisdiction provide for any kind of moratorium on enforcement of lender claims? If so, does the moratorium apply to the enforcement of collateral security?

Under the commencement of a reorganisation proceeding, secured lenders are granted priority over any other unsecured creditors for the enforcement of collateral. This makes it possible for the secured lenders to enforce their security interest during the reorganisation proceedings, only if the collateral is not required for the operation of the debtor's business.

In case the enforcement of collateral security is over movable assets or real property affecting the operation of the debtor's business, any lawsuit for execution or any other collection proceeding for these assets against the debtor will not continue from the date of commencement of the reorganisation proceeding.

Pursuant to the initiation of a judicial liquidation proceeding, the debtor's encumbered property would be excluded from the liquidation mass for the benefit of the secured lenders. Therefore, if there is no reorganisation agreement and the company enters into liquidation, the creditors will be paid in their respective order of priority, regarding the preference of the specific collateral over which the secured parties had a security interest, provided that there are still available funds and assets after paying creditors with a higher priority.

7.7 Will the courts in your jurisdiction recognise and enforce an arbitral award given against the company without re-examination of the merits?

Courts in Colombia may recognise and enforce arbitral awards after a recognition proceeding is completed in accordance with the 1958 New York Convention requirements. If the arbitral tribunal has taken place in Colombia, this recognition is not required and the arbitral award may be enforced without any re-examination.

8 Bankruptcy Proceedings

8.1 How does a bankruptcy proceeding in respect of a company affect the ability of a lender to enforce its rights as a secured party over the collateral security?

Duly granted collateral security provides priority to the secured lenders upon the initiation of bankruptcy proceedings, in relation to the asset taken as collateral. Creditors who hold collateral security (after 2013, based on Law 1676 of 2013) over the debtor's movable assets can enforce this security (subject to the registration conditions) for the payment of the debt (during a reorganisation proceeding). Such prerogative (i.e. direct enforcement of the guarantees during the reorganisation proceeding) can only be used if the movable assets are not necessary for the development of the economic activity of the debtor. In case the security was not granted over movable assets subject to Law 1676 of 2013, such guarantees would have the traditional prerogatives for the protection of the creditor and the ranking: (1) first class: employment and tax obligations; (2) second class: creditors with a pledge granted in their favour; (3) third class: creditors with a mortgage granted in their favour; (4) fourth class: other tax-related obligations; and (5) fifth class: creditors that do not hold a security to secure the debtor's obligations.

8.2 Are there any preference periods, clawback rights or other preferential creditors' rights (e.g., tax debts, employees' claims) with respect to the security?

Law 1116 of 2006 establishes the clawback actions that are aimed at revoking or recharacterising the acts or transactions carried out by the debtor before an insolvency proceeding. Such acts or transactions must have adversely affected other creditors or the priority payment order. The suspect periods applicable for these type of actions is: (i) 18 months: payment of obligations and any act or transaction resulting in the transfer, granting or cancellation of liens or property rights of the debtor that diminish its patrimony, or leases that hinder the reorganisation proceedings. In this scenario, there must not be any evidence that the transferee or lessee acted in good faith; (ii) 24 months: gratuitous acts; and (iii) six months: amendments to the by-laws when such amendments diminish the debtor's patrimony in prejudice of the creditors or modify the liability of the shareholders of the debtor.

8.3 Are there any entities that are excluded from bankruptcy proceedings and, if so, what is the applicable legislation?

The following entities have special bankruptcy proceedings: entities supervised by the Superintendence of Finance (*Superintendencia Financiera*); entities supervised by the Superintendence of Solidarity Economy (*Superintendencia de Economía Solidaria*) that perform financial activities; State-owned entities; public utilities entities; and entities that provide health services (*Entidades Promoras de Salud* and *Instituciones Prestadoras de Servicios de Salud*).

8.4 Are there any processes other than court proceedings that are available to a creditor to seize the assets of a company in an enforcement?

Pursuant to Law 1676 of 2013, it is possible to have a special execution of the guarantee of a movable asset in opposition to a judicial execution, upon the agreement of the parties to such special execution or if the pledge meets certain requirements provided under Law 1676 of 2013. This procedure is different from a court proceeding. This type of enforcement can be carried out before a Chamber of Commerce or a Notary Public, depending on the agreement of the parties.

9 Jurisdiction and Waiver of Immunity

9.1 Is a party's submission to a foreign jurisdiction legally binding and enforceable under the laws of your jurisdiction?

Colombian parties are permitted to submit to a foreign jurisdiction. Please refer to our answer to question 7.1 above.

9.2 Is a party's waiver of sovereign immunity legally binding and enforceable under the laws of your jurisdiction?

Yes. A party's waiver of sovereign immunity is legally binding and enforceable.

10 Licensing

10.1 What are the licensing and other eligibility requirements in your jurisdiction for lenders to a company in your jurisdiction, if any? Are these licensing and eligibility requirements different for a "foreign" lender (i.e. a lender that is not located in your jurisdiction)? In connection with any such requirements, is a distinction made under the laws of your jurisdiction between a lender that is a bank *versus* a lender that is a non-bank? If there are such requirements in your jurisdiction, what are the consequences for a lender that has not satisfied such requirements but has nonetheless made a loan to a company in your jurisdiction? What are the licensing and other eligibility requirements in your jurisdiction for an agent under a syndicated facility for lenders to a company in your jurisdiction?

There are no licensing requirements for foreign lenders in Colombia. Nevertheless, under Colombian foreign exchange regulations, foreign indebtedness and foreign lenders must be registered with the Colombian Central Bank prior to the disbursements of funds under a lending transaction with a Colombian borrower. This registration only requires the filing of a form with the local bank that acts as intermediary for the Colombian borrower and takes between one and two days.

11 Other Matters

11.1 Are there any other material considerations which should be taken into account by lenders when participating in financings in your jurisdiction?

Colombian residents may obtain loans in foreign currency from non-residents to fund any activity or purpose. Prior to the disbursement, the foreign indebtedness must be reported by the Colombian resident to the Colombian Central Bank through a foreign exchange intermediary. Additionally, a copy of the relevant loan agreement has to be submitted to the foreign exchange intermediary, along with any other documents that the intermediary may request. Disbursement and payments completed under the loan must be timely reported to the Colombian Central Bank.

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Our Financial Service Practice is recognised for its active involvement with the banking and finance industry in Colombia. Partners and associates of the firm have been involved in some of Colombia's most relevant lending and secured finance transactions. Likewise, partners and associates participate, or have participated in the past, as members of the board of directors of listed companies, institutions of the capital markets and entities under the surveillance of the Superintendence of Finance of Colombia.

Our members are well regarded for their in-depth knowledge of Colombian and cross-border financial and securities regulation that impacts lending and secured finance transactions.

Costa Rica

Hernán Cordero Maduro

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1 Overview

1.1 What are the main trends/significant developments in the lending markets in your jurisdiction?

Costa Rica's major trends continue to focus on issues related to fintech developments, online access to information and banking services, alternative lending platforms and a sound legal system which encourages the development of these new technological trends. The financial market continues to develop and adopt strategies in order to compete with PTP lending and crowdlending structures that are starting to generate a larger presence in the local market. In addition, new technologies are required to provide a higher standard, effective and secure services to their new, more tech-savvy customers. The traditional way of lending and banking services will continue to rule our current market; however, it has already began a steady transformation towards a more digital approach as well as other high-tech, online, web-based and app-oriented services. Regulatory entities as well as the legal framework continue to be challenged in order to include (or avoid the exclusion) of these new fintech initiatives into the regulatory framework.

1.2 What are some significant lending transactions that have taken place in your jurisdiction in recent years?

The most significant lending transactions that have taken place in recent years continue to be focused on government financial aid programmes, as well as infrastructure and development loan agreements. Some of the major transactions are as follows: Inter-American Development Bank: a US$150 million loan to create a programme to prevent violence and social exclusion; a US$500 million loan to finance investment projects under a comprehensive programme that covers: mitigation of the impacts of climate change, sustainable economic growth and the promotion of regional integration through the "Regional Electricity Market" for generation, transmission and distribution of electricity, along with the already owed US$1.483 million; with BCIE, a US$340 million loan aimed at infrastructure modernisation; a US$50 million loan for the purchase, construction, improvement or expansion of housing, and the development of housing projects and sustainable housing for the middle class in Costa Rica; and a US$48 million loan to finance the Wholesale Regional Market Project in the Chorotega region. In addition, there have been some recent significant lending transactions related to certain commercial real estate developments that are under construction in the greater metropolitan area of San José.

2 Guarantees

2.1 Can a company guarantee borrowings of one or more other members of its corporate group (see below for questions relating to fraudulent transfer/financial assistance)?

Yes, it can. However, there should be no limitations on undertaking such acts or contracts in the company's corporate statute or by-laws. The *Minority Investor Protection Law* amended certain articles of the Code of Commerce, and included article 32*ter* which refers to the requirement of corporate governance policies related to borrowing amongst members of its corporate group. This new law provides a special protection to minority shareholders and investors, specifically when it comes to authorising borrowings of those related parties (a member of its corporate group or an independent third-party company). Along with the *Minority Investor Protection Law*, and assuming that the corporate statute or by-laws establishes no limitations, it is required that borrowers comply with articles 1262 and 1263 of the Costa Rican Civil Code. In this regard, the borrower and/or the guaranteeing company must hold an extraordinary shareholders' meeting in which it analyses the terms and conditions of the transaction and expressly authorises its legal representative (or any other person) to act on behalf of the company in order to authorise the guarantee for the borrowings of that related third party (a member of its corporate group or an independent third-party company).

2.2 Are there enforceability or other concerns (such as director liability) if only a disproportionately small (or no) benefit to the guaranteeing/securing company can be shown?

Pursuant to Costa Rican law, if a company intends to guarantee or secure related third-party borrowings, it is required to show or justify a benefit or expressly indicate that it shall receive some kind of economic compensation. As indicated in question 2.1 above, in order to comply with corporate mandate rules, the company should analyse such compensation (whether small or significant) and expressly authorise its legal representative, by means of an Extraordinary Shareholders' Meeting, to represent the company in such act or contract.

2.3 Is lack of corporate power an issue?

Yes. All corporate undertakings must be executed by a legal representative of the company with sufficient power or else duly authorised – by the company's shareholders in a duly held shareholders' assembly – to execute the corresponding act or contract. If there is a lack of corporate power by the legal representative, then the act or contract may be rendered null and void. In addition, if a guarantee is subject to registration and the legal representative's power or authorisation is not duly recognised or granted, then the guarantee will not be properly recorded and as a result the lender may be negatively affected. The corporate powers for legal representatives are governed pursuant to Title VIII of the Costa Rican Civil Code.

2.4 Are any governmental or other consents or filings, or other formalities (such as shareholder approval), required?

Under Costa Rican law, government filings or consents for granting guarantees are not required. With regards to shareholder approval, this will be subject to the limitations (if any) that the company and/or its legal representatives may have pursuant to the corporate statutes or by-laws. If there are no registered limitations to the corporate statutes or by-laws, shareholder approval is not required for guaranteeing its own borrowings, as long as the legal representative has the sufficient corporate power to execute the corresponding act or contract; however a Board of Directors Meeting must take place in compliance with article 32*ter* of the Commerce Code, as indicated in question 2.1. Shareholder approval is required for guaranteeing the borrowings of its own shareholders and/or officers of the company and it is also required for borrowings of third parties. If there are registered limitations or restrictions on the corporate statutes or by-laws and/or limitations or restrictions on the appointment of legal representatives, then, as established in question 2.3 above, shareholders' approval is also required.

2.5 Are net worth, solvency or similar limitations imposed on the amount of a guarantee?

Under Costa Rican laws and regulations, this is not requirement. Nevertheless, upon granting a guarantee to a lender, the debtor should not be under a critical financial position that may be considered a technical insolvency affecting other lenders. Any acts or contracts executed under a technical insolvency may render those acts and contracts null and void. Upon the confirmation of a company's insolvency, acts or contracts executed up to six months prior to that confirmation (of insolvency) may be presumed null and void. Despite the above, local banks and/or financing entities that are subject to supervision by the Financial Entities Superintendence ("SUGEF") are obligated to comply with the SUGEF 1-05 Regulations whose purpose intends banks and financing entities to quantify its clients' credit capacity and related risks and forces them to establish the corresponding solvency safeguards.

2.6 Are there any exchange control or similar obstacles to enforcement of a guarantee?

No. There are no obstacles of this sort in order to enforce a guarantee. As a matter of fact, the Organic Law of the Costa Rican Central Bank ("*Ley Orgánica del Banco Central de Costa Rica*") specifically authorises private and public entities and/or individuals to enter into and execute private and public agreements using a foreign currency.

3 Collateral Security

3.1 What types of collateral are available to secure lending obligations?

Based on the definition of collateral as "property that is pledged as security against a debt or property subject to a security interest", the following are some types of collateral available to secure lending obligations in Costa Rica: mortgages or common mortgages ("*hipoteca*"); pledges ("*prenda*"); mortgage certificates ("*cédula hipotecaria*"); trust agreements ("*fideicomiso de garantía*"); and moveable guarantees ("*garantía mobiliaria*"). These types of collateral are explained in detail below.

3.2 Is it possible to give asset security by means of a general security agreement or is an agreement required in relation to each type of asset? Briefly, what is the procedure?

Yes, it is possible. In Costa Rica, trust agreements (also referred to as guarantee trust agreements) are usually used as a general security agreement in which real property (fee simple), concession rights, moveable assets, machinery, equipment and assignable rights can be transferred or assigned by the debtor or a third party (also referred to as the "Trustor") to a designated third party identified as a Trustee. The Trustee must hold the title of the assets or rights placed in trust as a collateral guarantee towards the lender (also referred to as the "Beneficiary") and must execute the trust agreement according to the instructions expressly indicated in such document. It is required that the instructions established in the trust agreement follow certain minimum due process rules of procedure.

The transfer of assets or rights to the Trustee can be executed by means of a private agreement, with the exception of registrable assets such as real property and certain vehicles and machinery which have to be transferred through a public deed ("*escritura pública*") executed exclusively by a Costa Rican Notary Public.

Upon the occurrence of an event of default by the debtor or Trustor under the trust agreement or the other loan documents, and failure to cure or at least take specific actions to cure the default, the Beneficiary must give written notice of the default to the Trustee and to the debtor or Trustor. If the debtor or Trustor fail to timely cure the event of default within the term granted in the trust agreement for this purpose, the Trustee must proceed to execute the auction of the trust estate.

3.3 Can collateral security be taken over real property (land), plant, machinery and equipment? Briefly, what is the procedure?

Yes. Collateral security can be taken over real property (fee simple) and moveable assets such as any type of plant, machinery, equipment, inventory, consumable goods as well as assignable rights.

The most common type of collateral security over real property is through a mortgage in which the debtor provides a property as a security to guarantee a specific loan. The lender and debtor agree on all terms and conditions, such as, but not limited to, mortgage grade, lender's name, debtor's name, loan amount, term, advance payment penalty, interest, loan currency, place of payment and the usual contractual clauses that will govern the loan and the mortgage. The mortgage lien – granted through a public deed before a Costa Rican Notary Public – is imposed over the registered real property and has to be recorded before the National Registry. The mortgage entry will be recorded on the property's ownership entry and will be publicly available.

Another type of security over real property is by means of a mortgage certificate. This security has the same legal force as a common mortgage. The National Registry issues the mortgage certificate that identifies the amount for which the certificate is issued and, unlike the common mortgage where there is an established lender, these certificates may be transferred by means of endorsement. In such cases, the mortgage certificate is also recorded as a lien on the property's ownership entry and will also be publicly available.

With regards to moveable assets, the most common type of collateral security is the pledge. All moveable assets that are legally subject to an auction and judicial persecution may be pledged to secure or guarantee a loan. Like mortgages, the pledge agreement must include certain terms and conditions such as: the lender's name; the debtor's name; the loan amount; the term; the advance payment penalty; the interest; the loan currency; the place of payment; and the characteristic contractual clauses that will govern the financing. The pledge lien imposed over registered or registrable moveable assets must be granted through a public deed before a Costa Rican Notary Public and recorded at the National Registry. Moveable assets which are non-registrable can also be granted as collateral pursuant to the *Moveable Guarantee Law*. This type of collateral is executed by means of a private document and recorded at the Moveable Guarantee Registry. This moveable guarantee provides more flexibility to the parties in order to be able to receive other types of moveable assets such as collateral and register that collateral in a verifiable registry. In addition to the above-indicated collateral security (mortgage and pledge), as indicated in question 3.2 above, another type of security is the trust agreement.

3.4 Can collateral security be taken over receivables? Briefly, what is the procedure? Are debtors required to be notified of the security?

Pursuant to Costa Rican law, a pledge collateral security can be taken over receivables as well as any other debt or credit. In order for the pledge to have legal value, it is required for the debtor to deliver or assign the receivable to the lender by way of a formal assignment, who is automatically appointed legal depositary (free of charge) of the receivable.

The lender is not allowed to dispose or take control of the collateral without the express consent of the debtor. Any agreement that violates the above will be considered null and void. It is customary to execute this pledge before a Notary Public in a public deed and/or a private document and register the security before the Moveable Guarantee Registry.

In addition, collateral security can be taken over these types of documents through a trust agreement. As established above, the receivable will be transferred to the Trustee who will execute the trust agreement according to the instructions expressly indicated in such document. This trust agreement is also recorded before the Moveable Guarantee Registry.

3.5 Can collateral security be taken over cash deposited in bank accounts? Briefly, what is the procedure?

Although a pledge collateral security can be taken over cash deposited in bank accounts in the same way as a receivable (see question 3.4 above), this is not common practice unless the lender is the same bank that grants the loan, manages the bank account and receives such security. The procedure is the same as that established above.

3.6 Can collateral security be taken over shares in companies incorporated in your jurisdiction? Are the shares in certificated form? Can such security validly be granted under a New York or English law-governed document? Briefly, what is the procedure?

Yes, collateral security can be taken over shares in companies (whether a corporation ("*Sociedad Anónima*") or a limited liability company ("*Sociedad de Responsabilidad Limitada*")). The most common way to take security over shares is through a pledge, which has to be executed according to Costa Rican Law. In the case of corporations (which have shares in the form of certificates), in order for the pledge to have legal value, it is required for the debtor to deliver the share certificates to the lender, who is automatically appointed legal depositary (free of charge) of the share certificates. In the case of limited liability companies (the shares of which, called "quotas", are not in a certificated form), in order for the pledge to have legal value, it should be registered in the company's Quota Holders' Registry Book and the quota holders, through a quota holders' general assembly, should approve it.

The lender is not allowed to dispose or take control of the shares unless the established execution process is followed. In order for this execution to be valid, it should follow the established due process. Any agreement that violates the above due process is considered null and void. Nevertheless, in case there is a non-fulfilment on behalf of the debtor, the lender can enforce the security either through a court of law or through a private executor ("*corredor jurado*") and recover regular and delayed payment interest.

In addition, collateral security can be taken over shares through a trust agreement. As established above, the shares are transferred to the Trustee who will execute the trust agreement according to the instructions expressly indicated in such document.

3.7 Can security be taken over inventory? Briefly, what is the procedure?

Yes, collateral security can be taken over inventory. Inventory in Costa Rica is described as the moveable assets that a person or entity holds for its sale or lease in the due course of its normal business activity, such as raw materials and/or goods required for transformation into sellable assets. As indicated in question 3.3 above, any moveable asset that is legally subject to an auction and judicial persecution may be pledged to secure or guarantee. These types of assets may also be subject to the registration as a moveable guarantee under the special registry for these types of assets. Taking into consideration that inventory is a moveable asset, it is subject to a pledge collateral security as indicated above. In addition, inventory can be transferred to a trust agreement as established in question 3.2 above.

3.8 Can a company grant a security interest in order to secure its obligations (i) as a borrower under a credit facility, and (ii) as a guarantor of the obligations of other borrowers and/or guarantors of obligations under a credit facility (see below for questions relating to the giving of guarantees and financial assistance)?

Yes, a company can grant a security interest in order to secure both its obligations as a borrower under a credit facility and as a guarantor of the obligations of another borrower under a credit facility.

However, as established in question 2.1 above, in order to comply with corporate mandate rules established in articles 1262 and 1263 of the Costa Rican Civil Code, if the company grants a security interest as a guarantor of obligations of other borrowers, it is the guaranteeing company who must hold a Board of Directors Meeting to approve the transaction, and an Extraordinary Shareholders' Meeting in which it analyses the terms and conditions of the transaction and authorises its legal representative (or any other person) to guarantee the borrowings of a third party (a member of its corporate group or an independent third-party company) on its behalf.

3.9 What are the notarisation, registration, stamp duty and other fees (whether related to property value or otherwise) in relation to security over different types of assets?

In Costa Rica, the notarisation, registration, stamp duty and other fees are established pursuant to the following legislation: (i) National Registry Tariff Law No. 4564; (ii) Notarial Code No. 7764; and (iii) General Tariff for Fees for Law and Notary Public Professionals No. 41457-JP. In this regard, depending on the act or contract that is being executed, there is a standardised cost for the notarisation and registration of security. In all instances, if the act or contract has an estimated amount, such fees and stamps are proportional to the estimated amount. If for some reason the amount cannot be estimated, then the fees and stamps are going to be subject to the type of act or contract and type of security taken.

3.10 Do the filing, notification or registration requirements in relation to security over different types of assets involve a significant amount of time or expense?

The time required to execute a specific security will ultimately depend on the type of security. For example, registration of a mortgage, mortgage certificate or pledge over registered or registrable assets before the National Registry will take approximately eight working days, taking into consideration that no formal or draft errors are identified by the National Registry.

With regards to expenses, it also varies on the type of security. In general, a security that is subject to registration (see question 3.11 below) will usually have filing and registration expenses that range between 0.60% and 2% of the estimated amount. Security that is not subject to registration will usually have filing and notification expenses that range between 0.15% and 1% of the estimated amount.

3.11 Are any regulatory or similar consents required with respect to the creation of security?

No specific regulatory consents are required with respect to the creation of security. However, some securities such as a mortgage or a pledge over registered/registrable assets require registration before the National Registry and, as a result, certain legal and regulatory requirements need to be met in order to register such collateral security. If these securities are not registered, then they are not going to be applicable to/enforceable on third parties. Nevertheless, consent is not required.

In addition, certain specific concessions (i.e. maritime zone concessions located under certain legal framework such as the *Polo Turístico de Papagayo*) may require administrative consent with respect to the creation of security.

3.12 If the borrowings to be secured are under a revolving credit facility, are there any special priority or other concerns?

When dealing with revolving credit facilities, it is customary to guarantee the total amount of the facility with a type of secured collateral such as a mortgage, mortgage certificate, pledge or trust agreement. This registration is normally done at the inception or beginning of the loan facility. Thus, if there are disbursements, these shall by guaranteed since the beginning. As established in question 8.1, creditors with these types of collateral have preference over non-secured creditors.

3.13 Are there particular documentary or execution requirements (notarisation, execution under power of attorney, counterparts, deeds)?

Pursuant to Costa Rican laws and general practice, most securities are executed through a public deed before a Notary Public. Notarised documents such as public deeds ("*escritura pública*") are subject to very detailed formalities established in Notarial Code No. 7764, and the Notary Public in charge of such execution must comply with documentary formalities and strictly follow corporate mandate rules (see questions 2.1 and 2.3 above). Notwithstanding the above, in recent years the trend has been to liberalise loans from these general formalities in order to grant more access to credit and financing possibilities.

4 Financial Assistance

4.1 Are there prohibitions or restrictions on the ability of a company to guarantee and/or give security to support borrowings incurred to finance or refinance the direct or indirect acquisition of: (a) shares of the company; (b) shares of any company which directly or indirectly owns shares in the company; or (c) shares in a sister subsidiary?

(a) Shares of the company

The Costa Rican Code of Commerce establishes that a company cannot purchase shares of its own capital stock, unless the purchase is made with funds obtained from the company's gross profits from its legally approved balance. Thus, a company cannot finance or borrow money to purchase its own shares. As a result, a company is restricted from guaranteeing or supporting borrowings for the purchase of shares of the same company. In any case, a company is legally limited to 50% ownership of its own capital stock.

(b) Shares of any company which directly or indirectly owns shares in the company

Beside the restrictions explained in question 2.1, there is no specific prohibition or restriction for a company to guarantee and/or give security to support borrowings incurred to finance or refinance the direct or indirect acquisition of shares of any company which directly or indirectly owns shares in the company.

(c) Shares in a sister subsidiary

Beside the restrictions explained in question 2.1, there is no specific prohibition or restriction for a company to guarantee and/or give security to support borrowings incurred to finance or refinance the direct or indirect acquisition shares in a sister subsidiary.

5 Syndicated Lending/Agency/Trustee/Transfers

5.1 Will your jurisdiction recognise the role of an agent or trustee and allow the agent or trustee (rather than each lender acting separately) to enforce the loan documentation and collateral security and to apply the proceeds from the collateral to the claims of all the lenders?

When dealing with syndicated loans, Costa Rica will recognise the role of an agent who will hold the security in its name and on behalf of the remaining lenders. Nevertheless, the Costa Rican Civil Code clearly establishes that there is no several liability between lenders; as a result, it is important to clearly establish in the financing documents the role of the agent within the syndication and the rules that it must follow – contractually – for the repayment of the loan, execution of the collateral, communication with the borrower, etc.

5.2 If an agent or trustee is not recognised in your jurisdiction, is an alternative mechanism available to achieve the effect referred to above which would allow one party to enforce claims on behalf of all the lenders so that individual lenders do not need to enforce their security separately?

A trust agreement is an alternative mechanism to that of the syndicated loan in which an agent is not recognised. Under a trust agreement structure, all the lenders would be the Beneficiaries, the borrower and/or that who provides the collateral would be the Trustor, and the Trustee would be a third party which receives the assets in trust and holds them (see question 3.2). Under Costa Rican law, there can be several Beneficiaries or lenders, as well as several Trustors or borrowers. Upon enforcement, the trust agreement must clearly stipulate who is responsible for executing the instructions under the trust agreement, which should always be a representative from the Trustee.

5.3 Assume a loan is made to a company organised under the laws of your jurisdiction and guaranteed by a guarantor organised under the laws of your jurisdiction. If such loan is transferred by Lender A to Lender B, are there any special requirements necessary to make the loan and guarantee enforceable by Lender B?

Assuming there is no limitation to assign or transfer the loan from Lender A to Lender B, in order for the assignment or transfer to be valid and enforceable against the borrower, the borrower must be duly notified of the assignment of that loan. In addition, it is important to certify the date of the assignment through a public deed granted before a Notary Public ("*fecha cierta de la cesión*"). The assignment will be valid to third parties from the moment it is certified pursuant to the above and its recording before the Moveable Guarantee Registry.

6 Withholding, Stamp and Other Taxes; Notarial and Other Costs

6.1 Are there any requirements to deduct or withhold tax from (a) interest payable on loans made to domestic or foreign lenders, or (b) the proceeds of a claim under a guarantee or the proceeds of enforcing security?

According to the Costa Rican Income Tax Law, interest payments made by Costa Rican corporations or entities to foreign lenders or financial institutions, as a result of the repayment of any loan, are subject to a 15% withholding tax in Costa Rica. If such interest payment is made to a foreign lender that is part of a bank group that is supervised locally, there is a withholding tax that ranges from 5.5% to 15%. In addition, if such interest payments are made by Costa Rican corporations to multilateral banks, development banks and other non-profit financial entities, the above-indicated withholding tax does not apply.

6.2 What tax incentives or other incentives are provided preferentially to foreign lenders? What taxes apply to foreign lenders with respect to their loans, mortgages or other security documents, either for the purposes of effectiveness or registration?

Please see question 6.1.

6.3 Will any income of a foreign lender become taxable in your jurisdiction solely because of a loan to, or guarantee and/or grant of, security from a company in your jurisdiction?

Costa Rica has a territorial tax system; thus, if a foreign lender grants a loan from abroad to a company established in Costa Rica, income generated through that loan or guarantee or grant of security is not taxable in Costa Rica. Nevertheless, as established in question 6.1 above, remittance of interest may be subject to a withholding tax depending on the type of entity.

6.4 Will there be any other significant costs which would be incurred by foreign lenders in the grant of such loan/guarantee/security, such as notarial fees, etc.?

Generally, other than the established withholding tax indicated above, lenders do not assume any other cost in order to grant a loan and secure such loan in Costa Rica. As established in this document, most collateral is executed through a Costa Rican Notary Public in a public deed that is usually registered before the corresponding Section of the National Registry. These costs, which are more specifically referred to in question 3.10 above, are always assumed by the borrower.

6.5 Are there any adverse consequences for a company that is a borrower (such as under thin capitalisation principles) if some or all of the lenders are organised under the laws of a jurisdiction other than your own? Please disregard withholding tax concerns for purposes of this question.

No. There are no adverse consequences.

7 Judicial Enforcement

7.1 Will the courts in your jurisdiction recognise a governing law in a contract that is the law of another jurisdiction (a "foreign governing law")? Will courts in your jurisdiction enforce a contract that has a foreign governing law?

The courts in Costa Rica will always recognise a governing law in a contract and enforce that contract, unless the specific subject matter goes against a public policy law ("*ley de orden público*") that strictly prohibits such subjection to foreign law.

7.2 Will the courts in your jurisdiction recognise and enforce a judgment given against a company in New York courts or English courts (a "foreign judgment") without re-examination of the merits of the case?

Yes. However, the following requirements have to be met: (a) the foreign judgment has been legalised by means of the Apostille Treaty or through the Costa Rican Consulate and translated into Spanish; (b) the foreign courts followed the established due process; (c) the subject matter of the foreign judgment was not tried in a Costa Rican court; (d) there is no former adjudication or *res judicata* on the same case by a Costa Rican court; (e) the rights declared in the foreign judgment are subject to execution in the forum where the judgment was rendered; and (f) the rights declared in the foreign judgment do not go against Costa Rican public policy laws.

7.3 Assuming a company is in payment default under a loan agreement or a guarantee agreement and has no legal defence to payment, approximately how long would it take for a foreign lender to (a) assuming the answer to question 7.1 is yes, file a suit against the company in a court in your jurisdiction, obtain a judgment, and enforce the judgment against the assets of the company, and (b) assuming the answer to question 7.2 is yes, enforce a foreign judgment in a court in your jurisdiction against the assets of the company?

In general terms, if the default under a loan agreement has been well established, the lawsuit may be prepared and filed immediately. In order to obtain a judgment, assuming that the debtor raises no procedural issues, an approximate timeframe would be six to ten months, minimum. In addition, enforcement of the judgment against the assets of the company can take an additional four to six months.

If we assume that all the legal requirements of the foreign judgment are in place, enforcement of such judgment in Costa Rica can take approximately between six and twelve months.

7.4 With respect to enforcing collateral security, are there any significant restrictions which may impact the timing and value of enforcement, such as (a) a requirement for a public auction, or (b) regulatory consents?

Under Costa Rican law, some of the most important restrictions which impact the timing and value of enforcements is when it is required to serve notice of the commencement of the legal proceeding. This first step in an enforcement case can be cumbersome and delay the proceeding. Once this is executed in accordance with due process and the established civil procedure rules, there are no consents that might delay the process. Notwithstanding the above, the most recent laws have significantly reduced the notification process, making the entire enforcement process less problematic.

7.5 Do restrictions apply to foreign lenders in the event of (a) filing suit against a company in your jurisdiction, or (b) foreclosure on collateral security?

No, there are no restrictions that apply to foreign lenders.

7.6 Do the bankruptcy, reorganisation or similar laws in your jurisdiction provide for any kind of moratorium on enforcement of lender claims? If so, does the moratorium apply to the enforcement of collateral security?

Upon declaration of bankruptcy, a moratorium on interest payments is declared to all borrowings not secured by means of a mortgage, mortgage certificate, pledge or similar. Although this moratorium does not apply to secured lenders, they cannot demand payment of the interest until the assets have been auctioned and proceedings paid.

7.7 Will the courts in your jurisdiction recognise and enforce an arbitral award given against the company without re-examination of the merits?

Yes. Please see question 7.2.

8 Bankruptcy Proceedings

8.1 How does a bankruptcy proceeding in respect of a company affect the ability of a lender to enforce its rights as a secured party over the collateral security?

Under Costa Rican law, lenders who have collateral security such as a perfected mortgage, pledge, mortgage certificate or trust agreement has a privileged right to enforce their security over unsecured creditors. The previous statement applies as long as the perfection of the security is not declared judicially fraudulent. In any event, any collection procedure that the lender executes will be brought before the same civil court where the bankruptcy proceeding is taking place.

Our law establishes a specific remedy ("*Acción Pauliana*") in order to request the nullity of any act or contract that has been executed up to two years prior to the declaration of bankruptcy which might affect unsecure creditors. In such case, the administrator of the bankruptcy has the power to begin such remedy action and the unsecured creditors may assist in such action.

8.2 Are there any preference periods, clawback rights or other preferential creditors' rights (e.g., tax debts, employees' claims) with respect to the security?

There are certain limited debts and obligations that have preference with respect to security. These have to be declared by a judge and the resulting liens are also known as legal mortgages which are established such as unpaid taxes, duly executed homeowners' association fees and some administrative charges. In this regard, these types of obligations have a priority with respect to the security.

8.3 Are there any entities that are excluded from bankruptcy proceedings and, if so, what is the applicable legislation?

There are only certain legal entities not subject to bankruptcy. These include the Government of Costa Rica, all public and autonomous institutions, local municipalities and State-owned banks.

8.4 Are there any processes other than court proceedings that are available to a creditor to seize the assets of a company in an enforcement?

Yes, there are several processes other than court proceedings available to seize the assets of a company during enforcement. Under most trust agreements – in which assets are transferred to the Trustee to hold them in trust to secure an obligation – upon the occurrence of an event of default by the debtor or Trustor (according to the terms and conditions of the trust agreement or the other loan documents) and failure to cure or at least take specific actions to cure the default, the creditor – also referred to as the Beneficiary – must give written notice of the default to the Trustee and to the Trustor. If the Trustor fails to timely cure the event of default within the term granted in the trust agreement for this purpose, the Trustee must proceed to execute the auction of the Trust Estate. The trust agreement must establish the rules to hold a private auction of the entrusted assets and, if there are no offers to the auction, the Trustee has the power to transfer the entrusted assets to the creditor or Beneficiary.

For a pledge agreement in which certain moveable assets are taken as collateral security (see question 3.6 above), upon an event of default, the lender can enforce the security through a private executor ("*corredor jurado*") and recover regular and delayed payment interest.

In addition, if a security contains an arbitration or conciliation clause, this process may be followed in order to seize – with the consent of the borrower – assets of a company.

In any case, under Costa Rican law it is strictly prohibited for creditors to immediately seize the assets of a company upon non-fulfilment of the terms and conditions or an event of default, such as lack of payment. This immediate seizure is also known as "*pacto comisorio*". All documents and processes must refer to an execution process (whether private or public, judicial or non-judicial) where due process is followed. Any agreement that violates the above will be considered null and void.

9 Jurisdiction and Waiver of Immunity

9.1 Is a party's submission to a foreign jurisdiction legally binding and enforceable under the laws of your jurisdiction?

A party's submission to a foreign jurisdiction is legally binding and enforceable under the laws of Costa Rica, unless there is a public policy law ("*ley de orden público*") that strictly prohibits such avoidance of domestic laws.

9.2 Is a party's waiver of sovereign immunity legally binding and enforceable under the laws of your jurisdiction?

Generally, yes.

10 Licensing

10.1 What are the licensing and other eligibility requirements in your jurisdiction for lenders to a company in your jurisdiction, if any? Are these licensing and eligibility requirements different for a "foreign" lender (i.e. a lender that is not located in your jurisdiction)? In connection with any such requirements, is a distinction made under the laws of your jurisdiction between a lender that is a bank *versus* a lender that is a non-bank? If there are such requirements in your jurisdiction, what are the consequences for a lender that has not satisfied such requirements but has nonetheless made a loan to a company in your jurisdiction? What are the licensing and other eligibility requirements in your jurisdiction for an agent under a syndicated facility for lenders to a company in your jurisdiction?

Lenders – whether local or foreign – do not need to be licensed or authorised in Costa Rica or in their jurisdiction of incorporation in order to be able to grant loans in Costa Rica. In addition, there are no eligibility requirements for lenders to local entities or individuals. Nonetheless, as indicated in question 2.5 above, local banks and/or financing entities that are registered in Costa Rica and as a result are subject to supervision by SUGEF, are obligated to comply with certain provisions such as SUGEF 1-05, among other local supervision regulations.

Notwithstanding the above, SUGEF recently enacted the SUGEF 11-18 Regulations, which requires certain entities that conduct certain activities, such as casinos, real estate brokers or intermediaries, pawn shops, jewellery and art stores, including persons or entities that are normally involved in lending transactions, to register before SUGEF. For now, this registration is only for informative purposes related to money laundering and the financing of terrorism and does not entail any sort of supervision or operative licence requirement. Nevertheless, not complying with this regulation will cause local banking authorities to close any banking accounts for any of these entities that are not registered before SUGEF.

11 Other Matters

11.1 Are there any other material considerations which should be taken into account by lenders when participating in financings in your jurisdiction?

Please see answer 10.1 above. Although foreign lenders do not require authorisation to grant loans in Costa Rica, they must have a corporate identification number ("*cédula jurídica*") in order to be identified as the lender in the financing documents to be registered at the corresponding Section of the National Registry. This corporate identification number is granted by the National Registry and it does not generate any legal or tax consequences.

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Croatia

Macesic & Partners LLC

Ivana Manovelo

1 Overview

1.1 What are the main trends/significant developments in the lending markets in your jurisdiction?

The lending market in Croatia has experienced growth in corporate lending over the last few years due to increased liquidity and facilitated conditions, a trend which continued in 2018. Croatia is currently in a favourable stage business-wise with an increase in loans, lower interest rates and a decrease in loan loss provision costs.

The Croatian National Bank reports that total corporate loans amounted to HRK 65.7 billion (around €8.85 billion) by the end of June 2018, which is a 1% increase from the same period in the previous year. This was the second month such increase was noted on a yearly basis, marking the end of a long downward trend, which lasted almost uninterruptedly since May 2012. Significant lending transactions are relatively rare on the Croatian lending market due to the inconsiderable number of larger companies and groups, some of them still government-owned. Developments worth mentioning occurred regarding the refinancing of the Croatian motorways loans. With the Government's approval, a loan contract has been signed with eight banks in April 2018 for the amount of €1.8 billion, restructuring the motorways debt. This solution is expected to save over €50 million per year. The World Bank has offered a guarantee in the amount of $350 million, making this transaction one of the largest in modern Croatian history.

Major infrastructure projects are not financed by private loans but through EU funds, EIB, EBRD and the Croatian Bank for Reconstruction and Development programmes. To name a few, the Peljesac Bridge construction drew €357 million from the Cohesion Policy funds and the LNG Terminal Krk (expected to commence operation on 1 October 2020) was awarded €101.40 million from the EU Connecting Europe Facility fund.

The sale of NPLs in Croatia hit a peak a few years ago, but continues to produce good results. In the first quarter of 2018, HRK 1.1 billion (around €148 million) was sold at the purchase price of 26.9%. According to the Croatian National Bank, the purchase price is exhibiting a steady increase on a yearly basis.

1.2 What are some significant lending transactions that have taken place in your jurisdiction in recent years?

In Croatia, 2017 was marked by the looming bankruptcy of Agrokor, one of the largest retail stock companies in South East Europe. In previous years, Agrokor had acquired several large companies (e.g. the biggest Slovenian retail chain Mercator valued at €500 million). However, failed negotiations for debt restructuring through a syndicate loan from BNP Paribas, Credit Suisse AG, London Branch, Goldman Sachs International and J.P. Morgan Limited due to unfavourable terms, Agrokor's expansionary moves and cross-collateralisation within the group brought them close to bankruptcy. Consequently, the parliament, on the basis of the Parmalat experience, adopted a law aimed at protecting the sustainability of business operations of systemically important companies ("Lex Agrokor"), allowing the government to appoint a trustee with the goal of reaching a settlement with creditors and eventually restructuring the company. In the restructuring procedure, existing creditors were given the option of a roll-up structure allowing old credit to take priority on the basis of new credit. A total of €960 million of fresh capital was attracted by this structure.

In July 2018, a settlement was signed between Agrokor and more than 5,700 of its creditors, making it the largest and most complex settlement in restructuring proceedings in Croatia. Currently, the settlement's implementation is under way. The group's first major challenge is the refinancing of roll-up loans in the amount of €1 billion. The group is currently formally owned by financial institutions – banks and investment funds. Sberbank holds 39.2% of Agrokor shares, the Knighthead fund (USA) holds 24.3%, and domestic financial institutions Zagrebačka banka and Erste&Steiermärkische Bank hold 15.3% each.

The implementation of the settlement is expected to be finalised by the end of March 2019, while the roll-up structure should be refinanced in the period from April to June. The future of Agrokor depends mainly on the refinancing which should be completed before entering the process of complete restructuring.

2 Guarantees

2.1 Can a company guarantee borrowings of one or more other members of its corporate group (see below for questions relating to fraudulent transfer/financial assistance)?

A company can guarantee borrowings of its members (downstream guarantees) only in accordance with the capital maintenance principle (see question 2.2), otherwise it is considered a prohibited distribution.

With regards to joint stock companies ("d.d."), any benefit of the company to its members can be granted only in the form of a dividend or reimbursement for non-monetary capital contributions on arm's-length terms.

There are two exemptions from the prohibited distribution rule that refer to distributions on the grounds of company management agreement and transfer of profit and loss agreement ("venture contracts"), which are not considered prohibited distributions.

Downstream guarantees are allowed and can also be given as an "additional obligation of the member" provided under the incorporation deed (not applicable for joint stock companies).

2.2 Are there enforceability or other concerns (such as director liability) if only a disproportionately small (or no) benefit to the guaranteeing/securing company can be shown?

An important principle of the corporate lending framework is the capital maintenance principle. It applies to limited liability companies ("d.o.o."), as well as to joint stock companies. Any distribution for the benefit of the member made contrary to arm's-length terms would be contrary to such principle and therefore prohibited. This means that any distribution (including all benefits and payments under the guarantee) is allowed if made in exchange for full value or with the obligation to return what is received. Establishment of an upstream guarantee would not be prohibited *per se* but only if this resulted with impairment of the company's assets according to the company's balance sheet (by payment, enforcement, etc.).

The consequence of such prohibited distribution is the obligation of the member to return the received benefit or its personal liability for damage to the company and its creditors ("lifting of the corporate veil"). If the company cannot recover the loss from the member which received the benefit or from the directors, other members may be liable for payment if prohibited distribution disables the company to settle obligations towards the creditors.

Maintenance of the company's capital is the obligation of the management and prohibited guaranteeing/securing may incur personal liability of the directors if a company's assets are impaired due to lack of due care of a prudent businessman.

2.3 Is lack of corporate power an issue?

Any limitations of management (specific conditions, consents, restrictions regarding the type of agreements) to represent the company do not affect the validity of agreements with third parties regardless of whether such limitation is visible on the Company Register.

2.4 Are any governmental or other consents or filings, or other formalities (such as shareholder approval), required?

In general, no governmental or other consents are required for granting guarantees. However, the consent of the Ministry of Finance is required if the Republic of Croatia is the guarantor, i.e., security provider. Possible limitation or special authorisation could be required under the provisions of incorporation deed or internal decisions of the company.

2.5 Are net worth, solvency or similar limitations imposed on the amount of a guarantee?

See question 2.2 regarding the capital maintenance principle.

2.6 Are there any exchange control or similar obstacles to enforcement of a guarantee?

There are no exchange controls or similar obstacles to enforcement of a guarantee.

3 Collateral Security

3.1 What types of collateral are available to secure lending obligations?

For the purpose of securing lending obligations, available types of collateral, according to Croatian law, are as follows:

- Security over receivables:
  - a pledge; and/or
  - a security assignment ("fiduciary transfer").
- Security over movables:
  - a pledge;
  - a mortgage ("registered security"); and/or
  - a fiduciary transfer of ownership.
- Security over immovables:
  - a mortgage; and/or
  - a fiduciary transfer of ownership.
- Security over shares:
  - a share pledge; and/or
  - a security assignment.

3.2 Is it possible to give asset security by means of a general security agreement or is an agreement required in relation to each type of asset? Briefly, what is the procedure?

Since the requirements and the procedure for creation, registration and enforcement of security are different for different types of assets, separate agreements for each type are usually required. Croatian law allows the creation of "a floating security" over generic movables. Such security must be sufficiently identifiable since a floating security over all assets of the debtor is not possible.

3.3 Can collateral security be taken over real property (land), plant, machinery and equipment? Briefly, what is the procedure?

There are two types of securities over immovables: (i) mortgage; and (ii) fiduciary transfer of ownership. Both securities are established by security agreement in the form of notarial deed and registration in the Land Registry. Mortgages ("*hipoteka*") are a more common form of security and are an accessory to the underlying receivable, which means they cannot be transferred independently of the receivable they secure. The difference between the mortgage and the fiduciary transfer is that the title of the property does not transfer to the mortgagee, unlike the fiduciary ownership where the ownership is limited and conditional upon the settlement of the secured receivable.

A mortgage over land plot may exceptionally be extended to movables located on the land plot, such as plant, livestock, machinery and equipment that serve the economic purpose of the building on the land plot.

For security over machinery and equipment please see question 3.7.

3.4 Can collateral security be taken over receivables? Briefly, what is the procedure? Are debtors required to be notified of the security?

Security in the form of a pledge or security assignment (fiduciary transfer of rights) may be established over receivables. Uniform rules apply to security over all rights, including receivables.

A pledge over receivables is established by two constitutive elements: (i) transfer of the right; and (ii) notification to the debtor. The registration of the security in the Register of Judicial and Notarial Securities Over Movables and Rights does not exclude the obligation of notifying the debtor.

The security assignment is based on the rules governing assignment ("*cessio*") of rights in general. The security becomes perfect when the agreement is concluded. In such case, notification to the debtor is required, but the assignment remains valid even if the debtor is not notified since the notification is not a constitutive element. However, if the debtor was not notified and the security over receivables is not registered or evident from the Register, the debtor is entitled to discharge his obligation by making the payment to the assignor.

Security over rights may be created either independently between the parties or with the involvement of the court or the notary public in the security proceeding. In the case of notarial or judicial security, the security is registered in the Register of Judicial and Notarial Securities Over Movables and Rights.

3.5 Can collateral security be taken over cash deposited in bank accounts? Briefly, what is the procedure?

Cash deposited in bank accounts is considered a receivable against the bank account. However, specific rules apply to financial securities over receivables against bank accounts (cash deposits, credit receivables and financial instruments). The security agreement must be in written form.

There are two types of securities: (i) pledge; and (ii) financial security transfer. The pledge entitles the beneficiary to use and dispose of the deposited cash of the security provider with the obligation to return or replace the security at the latest on the due date for the performance of the obligation covered by the security. The beneficiary of the security transfer has an unlimited right to use and dispose of the deposited cash. The security may be enforced directly by the beneficiary by sale, compensation or seizure.

3.6 Can collateral security be taken over shares in companies incorporated in your jurisdiction? Are the shares in certificated form? Can such security validly be granted under a New York or English law governed document? Briefly, what is the procedure?

Collateral security can be created over shares of joint stock companies and limited liability companies.

(i) Joint stock companies have shares that can be in dematerialised or in certificated form (in theory only; not used over the last several years). Security over certificated shares in bearer form is from the legal perspective considered as security over movables and is created by the security agreement and the transfer of possession.

In the case of dematerialised shares, the creation of security requires registration of the security in the Central Depository & Clearing Company ("CDCC"). If dematerialised shares are not registered in the CDCC, security is created by assignment ("*cessio*").

(ii) Security over shares of a limited liability company is created solely by an agreement that does not require notarial form. Registration in the book of shares is required but only has the function of publicity.

The beneficiary of the security does not acquire membership in the company and is only entitled to obtain profit without the right to vote.

Pursuant to Croatian conflict of laws rules, security over shares can be granted based on foreign documents; however, Croatian law applies to the enforcement of such security.

3.7 Can security be taken over inventory? Briefly, what is the procedure?

Security over movables may be established as: (i) a pledge with the transfer of possession; (ii) a mortgage; or (iii) fiduciary transfer of ownership. For the purpose of this question, movables such as vessels and aircraft are not considered inventory.

Security over movables can also be created in the security proceeding before courts or notary public (see question 3.4).

Securities over movables are not very common in Croatia.

3.8 Can a company grant a security interest in order to secure its obligations (i) as a borrower under a credit facility, and (ii) as a guarantor of the obligations of other borrowers and/or guarantors of obligations under a credit facility (see below for questions relating to the giving of guarantees and financial assistance)?

A company can grant a security interest in order to secure (i) its own obligations as a borrower, and (ii) itself as a guarantor of the obligations of other borrowers/guarantors under a credit facility. The latter being only if it is not contrary to limitations provided by Croatian company law (questions 2.1 and 2.2).

3.9 What are the notarisation, registration, stamp duty and other fees (whether related to property value or otherwise) in relation to security over different types of assets?

With regard to creating security, there are three possible fees depending on the type of assets: (i) fees of the notary public (when the security agreement is in the form of notarial act); (ii) registration fees (land registry, notarial and judicial registry, vessel's registry); and (iii) security proceeding fees if the security is created with the involvement of the court or the notary. The notary fees are subject to the value of the security object and prescribed by the notary's tariff. Notary fees can be significant, while the registration fees are usually minor.

3.10 Do the filing, notification or registration requirements in relation to security over different types of assets involve a significant amount of time or expense?

Filing, notification or registration requirements do not generally involve a significant amount of time (for expenses, see question 3.9). Registration in the land registry may take longer, depending on the court handling the registration.

3.11 Are any regulatory or similar consents required with respect to the creation of security?

In general, there is no consent required with respect to the creation of security. The consent may be required for creation of security over shares if provided so by the company's deed of incorporation.

3.12 If the borrowings to be secured are under a revolving credit facility, are there any special priority or other concerns?

There is no special priority or specific conditions in case the borrowings are secured under a revolving credit facility.

3.13 Are there particular documentary or execution requirements (notarisation, execution under power of attorney, counterparts, deeds)?

The security agreement should be in the form of a notarial deed or a notarised private document in order to be an enforceable document. It is important that the security agreement contains an *exequendi* clause – consent of the security provider to direct enforcement. Upon the request of the security beneficiary, the notary public issues an enforceability confirmation on the security agreement confirming that the requirements for enforcement are fulfilled.

Regarding the authorisation for any action with regards to creation or the enforcement of the security (except in the court proceeding), a special power of attorney is required and in some cases the power of attorney should be certified by the notary public or accompanied by an apostille.

4 Financial Assistance

4.1 Are there prohibitions or restrictions on the ability of a company to guarantee and/or give security to support borrowings incurred to finance or refinance the direct or indirect acquisition of: (a) shares of the company; (b) shares of any company which directly or indirectly owns shares in the company; or (c) shares in a sister subsidiary?

(a) Shares of the company

With regard to joint stock companies, Croatian law explicitly provides that an agreement under which the company grants financial assistance to third parties in the form of advance payment, security or loan for acquisition of its own shares is invalid. This does not apply to (i) operation of credit and financial institutions, and (ii) financial assistance for acquisition of shares by the employees of the company.

There is no explicit provision on financial assistance for acquisition of shares of the limited liability company; however, the general rule of capital maintenance would apply.

(b) Shares of any company which directly or indirectly owns shares in the company

Provision on the invalidity of the agreement explicitly applies to financial assistance for acquisition of shares of the company that owns shares of the company providing financial assistance.

(c) Shares in a sister subsidiary

Provision on the invalidity of the agreement explicitly applies to financial assistance for acquisition of shares of the sister company.

5 Syndicated Lending/Agency/Trustee/Transfers

5.1 Will your jurisdiction recognise the role of an agent or trustee and allow the agent or trustee (rather than each lender acting separately) to enforce the loan documentation and collateral security and to apply the proceeds from the collateral to the claims of all the lenders?

Croatian banks, together with local or foreign banks, have been providing syndicated loans. So in principle, yes, agents are recognised by practice, although not closely regulated, from the bylaws regulating the credit institutions and official opinions from the Tax Authority, the role of an agent (one of the lenders) is to coordinate all transactions between the lenders and the borrowers, as well as running administrative operations and balance sheets for all lenders. Furthermore, it arises that the agent acts in the name and for the account of other lenders and that he is authorised to collect payments on behalf of all lenders from the borrower. In the case where creditors are joint and several, each of the creditors could enforce the whole claim. The agent being the debtor itself could initiate the proceeding; however, success of possible objections from the borrower is uncertain since there is no court practice. Finally, Croatian law does not recognise the concept of trust.

5.2 If an agent or trustee is not recognised in your jurisdiction, is an alternative mechanism available to achieve the effect referred to above which would allow one party to enforce claims on behalf of all the lenders so that individual lenders do not need to enforce their security separately?

According to the Croatian Obligations Act, when there is more than one creditor of one claim, if such creditors are joint and several, each of them is entitled to enforce the whole claim and redistribute the collected amount among the creditors. With respect to the secured claim, when security is registered in public registries, only the registered creditor could enforce the security.

5.3 Assume a loan is made to a company organised under the laws of your jurisdiction and guaranteed by a guarantor organised under the laws of your jurisdiction. If such loan is transferred by Lender A to Lender B, are there any special requirements necessary to make the loan and guarantee enforceable by Lender B?

For the loan and guarantee to be enforceable, the loan should be assigned either by (a) assignment of claim when one claim is transferred from one creditor to another, or by (b) transfer of the contract when all rights and obligations from the contract are transferred from one party to the new party. With respect to the guarantee, when the claim is (a) assigned – all rights including the rights from the guarantee are transferred to the new creditor and enforceable by the new creditor. With respect to the transfer of contract (b), the guarantees would also be transferred and enforceable unless the guarantor objects to guarantee the creditor.

6 Withholding, Stamp and Other Taxes; Notarial and Other Costs

6.1 Are there any requirements to deduct or withhold tax from (a) interest payable on loans made to domestic or foreign lenders, or (b) the proceeds of a claim under a guarantee or the proceeds of enforcing security?

Interest paid to foreign lenders (not natural persons) in Croatia are subject to withholding tax. The obligator of withholding tax is the payee – the borrower. Exceptionally, interest paid on loans given by foreign banks or other financial institutions are not subject to withholding tax. Payment of withholding tax by foreign entities is regulated under bilateral treaties or the domestic Income Tax Act. If a bilateral treaty regarding the avoidance of double taxation exists, such treaties would regulate the taxation of interest payable on loans. Depending on each treaty, withholding tax can be reduced or not paid at all. In each case, the certificate issued and notarised by a competent foreign body should be obtained and filed with the tax authority in order that such tax obligation is deduced. If there is an absence of treaties regulating avoidance of double taxation, interest payable on loans is subject to 15% withholding tax. Regarding domestic lenders, there are no special provisions. The profit from the interest, together with the total annual income, is taxed according to annual income tax.

There are no special requirements to deduct or withhold tax from (b) proceeds of a claim under a guarantee or the proceeds of enforcing security.

6.2 What tax incentives or other incentives are provided preferentially to foreign lenders? What taxes apply to foreign lenders with respect to their loans, mortgages or other security documents, either for the purposes of effectiveness or registration?

There are no special taxes or other incentives provided preferentially to foreign lenders. No taxes apply to foreign lenders with respect to loans, mortgages or other security documents for the purposes of effectiveness or registration. With regards to fees for registration, please see question 3.9.

6.3 Will any income of a foreign lender become taxable in your jurisdiction solely because of a loan to, or guarantee and/or grant of, security from a company in your jurisdiction?

A foreign lender would not be taxable in Croatia solely because of a loan or guarantee or grant of security from a company in Croatia.

6.4 Will there be any other significant costs which would be incurred by foreign lenders in the grant of such loan/guarantee/security, such as notarial fees, etc.?

Please see question 3.9.

6.5 Are there any adverse consequences for a company that is a borrower (such as under thin capitalisation principles) if some or all of the lenders are organised under the laws of a jurisdiction other than your own? Please disregard withholding tax concerns for purposes of this question.

In general, there should be no adverse consequences to borrowers in the case where all or some lenders are foreigners.

7 Judicial Enforcement

7.1 Will the courts in your jurisdiction recognise a governing law in a contract that is the law of another jurisdiction (a "foreign governing law")? Will courts in your jurisdiction enforce a contract that has a foreign governing law?

Croatian courts would recognise a foreign governing law in a contract. The parties are free to incorporate a law of any jurisdiction since freedom of choice is one of the cornerstones of conflict of law rules legislation. According to the Conflict of Rules Act, the contract is governed by a law chosen by the parties where such choice is not limited to EU law or any conventions. However, if such law is contrary to the Constitution, it would not be recognised. 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) is also applied.

Croatian courts, if found to be competent, would enforce a contract that has a foreign governing law provided that provisions of law are not contrary to the Constitution and *ordre public*.

7.2 Will the courts in your jurisdiction recognise and enforce a judgment given against a company in New York courts or English courts (a "foreign judgment") without re-examination of the merits of the case?

Different rules apply for recognition of foreign judgments, depending on whether a judgment was given by a court of EU or a non-EU Member State:

Recognition of a judgment given by a court of an EU Member State (e.g. English court) is regulated by 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 (Brussel I) which regulates that a judgment given in an EU Member State shall be recognised in other EU Member States without any special procedure being required, i.e. without re-examination of the merits of the case.

Recognition of a judgment given by a court of a non-EU Member State (e.g. New York court) is regulated by the Conflict of Rules Act and such judgments are recognised without re-examination of the merits. In the procedure of recognition before the court, the court will only check whether formal requirements are fulfilled, i.e:

- if such judgment was final in the state of origin;
- whether there is exclusive jurisdiction of Croatian courts;
- whether there is already an existing judgment (*res judicata*);
- whether the judgment is contrary to the Constitution; and
- whether there is reciprocity between the origin state and Croatia with respect to recognition of foreign judgments.

7.3 Assuming a company is in payment default under a loan agreement or a guarantee agreement and has no legal defence to payment, approximately how long would it take for a foreign lender to (a) assuming the answer to question 7.1 is yes, file a suit against the company in a court in your jurisdiction, obtain a judgment, and enforce the judgment against the assets of the company, and (b) assuming the answer to question 7.2 is yes, enforce a foreign judgment in a court in your jurisdiction against the assets of the company?

The timeframe for obtainment and enforcement of a judgment depends on certain factors such as the complexity of the case and the promptness of the court, which again depends on the workload of the court, and finally the type of assets – whether bank accounts, movable or immovable property are enforced. For obtainment and enforcement of judgment (a), judgment could be obtained, on average, within three years and then enforced within months (when enforcing bank accounts with sufficient funds) to three years (when enforcing immovables). This would mainly depend on whether an appeal was lodged against the first instance judgment which can prolong the process for approximately one year. For (recognition) and enforcement of a foreign judgment, (b) could also take from a few months to a few years, again, depending on the type of assets, financial situation of the debtor and workload of the court.

7.4 With respect to enforcing collateral security, are there any significant restrictions which may impact the timing and value of enforcement, such as (a) a requirement for a public auction, or (b) regulatory consents?

Significant restrictions that may impact the timing and value of enforcement include public auctions – which are mandatory in enforcement proceedings (one to two public auctions for immovables and one auction for movable property). Croatian law does not propose any regulatory consents with respect to enforcement of collateral security.

7.5 Do restrictions apply to foreign lenders in the event of (a) filing suit against a company in your jurisdiction, or (b) foreclosure on collateral security?

No special restrictions apply to foreign lenders in the event of (a) or (b). However, where there is no reciprocity, i.e. treaties between the country of the seat of a foreign lender and Croatia regarding proceeding costs, it could be requested that the foreign lender plaintiff gives security for payment of proceeding costs. Also, if such foreign lender plaintiff does not have its seat or representation (e.g. attorney) in Croatia, they will have to appoint a delivery agent to be served with court documents during the proceeding.

7.6 Do the bankruptcy, reorganisation or similar laws in your jurisdiction provide for any kind of moratorium on enforcement of lender claims? If so, does the moratorium apply to the enforcement of collateral security?

The Bankruptcy Act provides that once pre-bankruptcy proceedings or bankruptcy proceedings are opened, no enforcement proceedings are allowed against the debtor, up to the closure of such proceeding. The proceedings are deemed to be opened once the decree that the proceeding is opened is published on an electronic bulletin board of the court. Moratorium does not apply to enforcement of collateral security if such debtor has the right of separate security (e.g. mortgage on real-estate registered in Land Registry).

Also, in 2017, a new Act on the extraordinary management procedure in companies of systemic importance for the Republic of Croatia (*Lex Agrokor*) – i.e. companies that employ more than 5,000 workers and have over €1 billion of debt – entered into force. The same rules apply as in the (pre-)bankruptcy proceeding with regards to moratorium and secured claims.

7.7 Will the courts in your jurisdiction recognise and enforce an arbitral award given against the company without re-examination of the merits?

Recognition of foreign arbitral awards is regulated by the Arbitration Act. Croatian courts would recognise and enforce arbitral awards given against the company without re-examination of the merits, subject to the arbitration award not being contrary to the public order and that there is no exclusive jurisdiction of Croatian courts. Croatia is also a party to the Convention on Recognition and Enforcement of Foreign Arbitral Awards (the New York Convention 1958).

8 Bankruptcy Proceedings

8.1 How does a bankruptcy proceeding in respect of a company affect the ability of a lender to enforce its rights as a secured party over the collateral security?

In (pre-)bankruptcy proceedings, creditors with secured claims have preferential status, i.e. they can use their right of "separate settlement". Such creditors have the right for their claim to be reimbursed from the proceeds of sale of their collateral, whereas other creditors with non-secured claims can only be reimbursed from the proceeds of sale from the remainder of other unencumbered assets.

8.2 Are there any preference periods, clawback rights or other preferential creditors' rights (e.g., tax debts, employees' claims) with respect to the security?

Bankruptcy trustees, as well as the creditors, may challenge legal actions taken prior to the opening of the bankruptcy proceedings if such actions are deemed to disrupt the balanced settlement of the creditors, or legal actions that benefit certain creditors (clawback), as follows:

(i) actions taken three months prior to filing a motion for opening a bankruptcy proceeding or after, by which action a creditor was able to settle/secure his claim, can be challenged if such action was taken at a time when the debtor was insolvent and if the creditor was aware of his insolvency or was aware that the bankruptcy proceeding was opened;

(ii) actions which allow one creditor to settle/secure a claim that he is not entitled to/claim that is not due, if such action was taken in the last month before filing a motion for opening a bankruptcy proceeding or was taken two or three months before filing such motion if the debtor was insolvent or when the creditor was aware that such action would damage other creditors;

(iii) actions which directly damage the creditors if such actions were taken three months prior to filing a motion for opening a bankruptcy proceeding and if the debtor was insolvent and the other party was aware of such insolvency or if it was taken after – if the other party was aware of the debtor`s insolvency or that the motion was filed;

(iv) actions taken by the debtor in the last 10 years prior to filing a motion for opening the bankruptcy proceeding or after, with the purpose of damaging the creditors if the other party was aware of such intentions of the debtor;

(v) debtor's actions without compensation taken within four years prior to filing a motion for the opening of bankruptcy proceedings; and

(vi) actions by which the shareholder's claim for loan replacing the share capital or other similar claim is secured, when such action is taken five years prior to filing a motion for the opening of bankruptcy proceedings or after, or giving a guarantee for the claim if such action is taken one year before filing the motion for the opening of bankruptcy proceedings.

Employees' claims are considered to be "first class I claims" and have priority over all other claims.

8.3 Are there any entities that are excluded from bankruptcy proceedings and, if so, what is the applicable legislation?

Bankruptcy and pre-bankruptcy proceedings cannot be initiated against the Republic of Croatia, funds financed by the Republic of Croatia, the Croatian Health Insurance Fund, the Croatian Pension Insurance Institute and local and regional self-governing units.

8.4 Are there any processes other than court proceedings that are available to a creditor to seize the assets of a company in an enforcement?

Assets are normally seized in court proceedings.

9 Jurisdiction and Waiver of Immunity

9.1 Is a party's submission to a foreign jurisdiction legally binding and enforceable under the laws of your jurisdiction?

A party's submission to a foreign jurisdiction is legally binding unless there is exclusive jurisdiction of Croatian courts for such submission according to the Croatian legislature. According to the Croatian Conflict of Rules Act, the parties can choose the forum if at least one of the parties is a foreigner or a foreign company and there is no exclusive jurisdiction of the Croatian court. Also, according to Article 25 of Brussels I Regulation, the parties can choose, in a written agreement, that a certain court of an EU Member State has jurisdiction and such court would be competent unless the agreement is null and void as to its substantive validity under the law of that Member State.

9.2 Is a party's waiver of sovereign immunity legally binding and enforceable under the laws of your jurisdiction?

A party's waiver of sovereign immunity is legally binding and enforceable. Such waiver should always be given explicitly.

10 Licensing

10.1 What are the licensing and other eligibility requirements in your jurisdiction for lenders to a company in your jurisdiction, if any? Are these licensing and eligibility requirements different for a "foreign" lender (i.e. a lender that is not located in your jurisdiction)? In connection with any such requirements, is a distinction made under the laws of your jurisdiction between a lender that is a bank *versus* a lender that is a non-bank? If there are such requirements in your jurisdiction, what are the consequences for a lender that has not satisfied such requirements but has nonetheless made a loan to a company in your jurisdiction? What are the licensing and other eligibility requirements in your jurisdiction for an agent under a syndicated facility for lenders to a company in your jurisdiction?

Loans can be given by a financial institution ("*kredit*") or by any other natural or legal person ("*zajam*"), wherein the differences between the two, other than the aforementioned entity authorised to give such a loan, are: a *kredit* agreement should always be in writing, the object of the loan is always money and interest always apply; while a *zajam* agreement is a non-formal contract – the object of the contract can be money or another fungible object, with or without interest. Therefore, under Croatian law, a distinction is made between a lender that is a financial institution and a lender that is a non-financial institution. Pursuant to Croatian banking and financing laws, a bank should obtain a special licence to operate as a bank from the Croatian National Bank. There are no special licensing requirements for other (foreign) legal and natural persons to give loans.

With respect to foreign lenders, i.e. foreign financial institutions, they can give loans in Croatia if such financial institutions are incorporated within the EU and have a subsidiary in Croatia or are authorised to directly operate as financial institutions in Croatia or banks from other countries that have a subsidiary in Croatia.

A *kredit* loan given by a lender without the proper licence would be considered null and void, while the lender or their management could be punished with fines for an offence, depending on each case.

Croatian law does not specifically regulate an agent under a syndicated facility. Consequently, no licensing and eligibility requirements apply.

11 Other Matters

11.1 Are there any other material considerations which should be taken into account by lenders when participating in financings in your jurisdiction?

Most of the relevant and general issues have been covered in this chapter. Possible material considerations that should be taken into account depend on a broad variety of circumstances in each case. Some general considerations while participating in financing in Croatia is that the lending is regulated by the Croatian Obligation Act and by an Act on financial operations and pre-bankruptcy settlement. Both acts also regulated interest rates. Interest rates depend on the reference rate set by the Croatian National Bank.

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Macesic & Partners is one of the oldest Croatian law firms operating through two offices in Zagreb and Rijeka, covering the entire territory of Croatia. It developed from the partnership of Miroljub Macesic and Anamari Laskarin. The practice of Miroljub Macesic was combined (when he took over) in 1993 with the practice of Georgije Ivkovic, who acted as an attorney-at-law from 1970.

The firm employs four lawyers, all of whom speak English, three speak Italian and one French. The firm's main business activities are: corporate; banking and financing; transport; insurance; energy; real estate; intellectual property; and litigation and arbitration. The firm's attorneys are experienced in running complex, multi-disciplinary and multi-million-euro matters with international elements. The firm provides specific knowledge on conflict of law rules, recognition and enforcement of foreign judgments and arbitration awards, security of claim measures, ascertainment and preservation of facts and evidences and similar expertise, serving its clients by meeting their requests and always providing a high-quality service. The firm is a part of several professional and expert organisations and associations and listed in all major professional directories. It regularly acts as a local correspondent for numerous international law firms.

Cyprus

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1 Overview

1.1 What are the main trends/significant developments in the lending markets in your jurisdiction?

Cyprus has come a long way since the national financial crisis of 2013.

Paving the way for the recovery of the Cypriot banking and financial system, the focus has been on certain key objectives, including the implementation of structural reforms aimed at enhancing competitiveness and sustainable and balanced growth.

Six years on, the measures continue to make a positive impact: deposits have stabilised and official data released by the Cyprus Statistical Service confirms the continuing growth rate for Cyprus, which, in real terms, during the fourth quarter of 2018 was positive and estimated at 4.0% above the corresponding quarter of 2017.

Although levels of non-performing loans (NPLs) still remain relatively high, recent Central Bank of Cyprus (CBC) statistics confirm that in the month of September 2018, non-performing facilities fell by more than one-third, from €16.595 billion to €11.021 billion, marking the lowest level of NPLs since the 2013 financial crisis. This marked reduction is mainly due to the acquisition by Hellenic Bank of the performing part of the state-owned Cyprus Cooperative Bank, which, following the latter's conversion to an asset management company, has undoubtedly facilitated the reduction of NPLs in the Cypriot banking system to a significant degree.

Finally, recently implemented structural measures that are expected to further assist in de-leveraging and alleviating the high level of NPLs on banks' balance sheets include the enactment of (i) the Sale of Credit Facilities and Related Matters Law of 2015 (which allows non-banking legal entities to buy local credit facilities from Cyprus banks), and (ii) the Securitisation Laws of 2018, which will create an effective and transparent framework to enhance legal certainty amongst market participants as well as allow for the broader distribution of risk and the liberation of capital from originators' balance sheets for further lending.

1.2 What are some significant lending transactions that have taken place in your jurisdiction in recent years?

Increased availability of debt leverage deals has had a significant impact on transaction volumes. Generally, however, new lending remains at a low level.

2 Guarantees

2.1 Can a company guarantee borrowings of one or more other members of its corporate group (see below for questions relating to fraudulent transfer/financial assistance)?

Generally speaking, a Cypriot company can provide guarantees for the borrowings of one or more members of its group, if (i) there is commercial benefit in it doing so (whether direct or indirect), and (ii) it is permitted to do so under its constitutional documents.

By way of example, it may be argued that a parent company granting a downstream guarantee to its subsidiary to secure the latter's borrowing obligations towards a third party has commercial benefits not only for the wider group but also for the parent company itself; especially where, as a result of the giving of the guarantee, the subsidiary can sustain upward profitability, and in turn, the distribution of increased dividend payments to its parent.

2.2 Are there enforceability or other concerns (such as director liability) if only a disproportionately small (or no) benefit to the guaranteeing/securing company can be shown?

Directors (acting always as a board) owe certain duties to the company which derive from both statute and common law. Under common law, these fiduciary duties include the duty of the directors to exercise their powers in good faith for the purposes for which they were conferred, and to act in the best interests of the company as a whole; i.e. all the shareholders of the company as a general body and not in the interests of a named shareholder and/or shareholders.

In the absence of judicial guidance on the matter, it is not clear whether the absence (or insufficiency) of corporate benefit would render a guarantee void, and consequently a creditor's rights thereunder, unenforceable. Given this grey area, the directors of a company should be able to demonstrate that they have fully considered corporate benefit issues and relevant considerations will invariably include the likelihood of the guarantee being called (as against the benefit to be derived by the company entering into the guarantee) and, if so called, whether the company is able to meet its financial obligations thereunder and still remain solvent.

Notwithstanding the above, relief from directors' duties may be sought from the shareholders in a general meeting, provided there is no fraud on the minority. It is considered good practice to have a shareholders' resolution in place to ratify, confirm and approve any decision of the directors to approve the company in acting as guarantor. Relief may also be sought under the Companies Laws of Cyprus, Cap. 113, as amended. The relevant statutory provision provides that in proceedings brought against a director for breach of duty, the relevant director may be absolved from liability, provided that he or she can prove that he or she acted honestly and reasonably, with regard to all the circumstances.

2.3 Is lack of corporate power an issue?

The memorandum and articles of association of a company should be carefully vetted in order to determine whether the granting of guarantees is within the company's objects. Even if no express power is granted, and provided they are not expressly prohibited, the objects may be so broadly drafted, so as to include the granting of guarantees as being ancillary to and in furtherance of the objects of the company. An act which is not authorised by the objects clause of the memorandum is *ultra vires*, i.e. beyond the company's powers as set out in its memorandum and void *ab initio*, and may not be remedied by any subsequent act of the shareholders.

Section 33A of the Companies Law, Cap. 113 ("Companies Law") attempted to do away with the *ultra vires* doctrine by providing that a company will be bound *vis-à-vis* third parties by acts or transactions of its officers, even if they do not fall within the objects of the company, provided that (i) the third party acted in 'good faith', and (ii) the acts in question do not exceed the powers prescribed by law, or which the law permits to be prescribed, to the officers concerned. Publication of the memorandum and articles does not in itself constitute sufficient proof of knowledge *vis-à-vis* the third party.

2.4 Are any governmental or other consents or filings, or other formalities (such as shareholder approval), required?

See question 3.9 below on stamp duty.

No governmental consents, filings or registration requirements are needed in order to grant a guarantee.

Whether a shareholder resolution is required is a matter for the articles of association of a company. In certain circumstances, shareholder approval may be required to whitewash any transactions which constitute prohibited financial assistance (see section 4 below) and/or to eliminate the risk of a transaction being rendered void for lack of corporate benefit (see question 2.2 above). More often than not, however, and irrespective of whether the articles of association require it, a shareholders' resolution will be put in place as a matter of good corporate practice.

Guarantees, being contracts, must comply with certain essential elements to ensure their validity and enforceability including an offer, an acceptance, the intention to create legal relations and consideration. Typically, the beneficiary of the guarantee must also provide consideration for the guarantor's promise (which may often prove difficult to demonstrate) and so to avoid a guarantee falling foul of contract law requirements for want of consideration, it is often executed as a deed.

2.5 Are net worth, solvency or similar limitations imposed on the amount of a guarantee?

No net worth, solvency or similar limitations are imposed on the amount of a guarantee. However, any guarantee given by a company should not exceed the value of the underlying obligation it secures given that the liability of a guarantor is co-extensive with (and should therefore not be greater than) that of the principal debtor, unless otherwise provided by the contract.

Please also see question 8.2 below.

2.6 Are there any exchange control or similar obstacles to enforcement of a guarantee?

There are no exchange control restrictions to enforcement of a guarantee.

A guarantee may be subject to stamp duty in Cyprus. An unstamped guarantee may not be adduced as evidence in Cyprus court enforcement proceedings unless stamp duty fees (including any penalties for late payment) have been settled.

3 Collateral Security

3.1 What types of collateral are available to secure lending obligations?

Generally speaking, any type of asset may be encumbered or charged to secure lending obligations in Cyprus.

The most common forms of collateral are:

- immovable property (such as land and/or any building, structure or thing affixed to it);
- tangible movable property (chattels);
- financial instruments such as shares and debt securities (claims and receivables);
- cash; and
- intangible movable property, such as intellectual property.

3.2 Is it possible to give asset security by means of a general security agreement or is an agreement required in relation to each type of asset? Briefly, what is the procedure?

It is possible to give asset security by means of a general security agreement in the form of a single fixed and floating charge debenture over various asset classes owned by a chargor.

The debenture will standardly include a fixed charge over particular assets, thereby giving a chargee control over any dealings or disposals of a particular asset by the chargor. It will also include a floating charge in relation to that part of the chargor's asset pool which is less ascertainable from time to time and which confers on the chargee the right to deal with the assets subject to the floating charge in the ordinary course of business. A debenture will also generally extend to include any assignment of receivables and contracts as well as any mortgages on immovable property and shares.

Practically speaking, it is more common to have in place specific security agreements in relation to certain assets such as land and shares (see questions 3.3 and 3.6 below, respectively), with any other assets being caught by an all-encompassing debenture creating security over all asset classes owned by a charger; in this way, any additional statutory perfection requirements and formalities affecting the validity and enforceability of a particular security arrangement are more easily satisfied.

3.3 Can collateral security be taken over real property (land), plant, machinery and equipment? Briefly, what is the procedure?

Collateral security may be taken over plant, machinery and equipment by way of a fixed charge debenture.

In terms of real or immovable property, security is taken by way of a mortgage of the property in favour of the mortgagee, pursuant to the provisions of the Immovable Property (Transfer & Mortgage)

Law, Law 9/1965, as amended; which requires, as a priority point, for the mortgage instrument to be deposited with the District Lands Office in the district where the relevant property is located. Upon registration, no subsequent transfer or further mortgaging of the mortgaged property is possible except with the mortgagees' prior consent.

3.4 Can collateral security be taken over receivables? Briefly, what is the procedure? Are debtors required to be notified of the security?

Collateral security over receivables is possible as either: (i) an assignment by way of security (subject the assignability of the receivables in question); or (ii) a fixed charge; or (iii) a floating charge (see question 3.2 above).

Cypriot law does not recognise the concept of a legal assignment and the assignment of a receivable, as a chose in action, will invariably take the form of an equitable assignment. Provided that the intention to assign has been notified, being both a perfection and priority requirement as against subsequent creditors, equity will recognise it. The assignment is effective only once notified to the assignee.

3.5 Can collateral security be taken over cash deposited in bank accounts? Briefly, what is the procedure?

It is possible to take collateral security over cash deposited in a Cyprus bank account by way of a fixed or floating charge.

It is common to take a fixed charge over a blocked deposit account with any withdrawals from that account by the chargor made possible only with creditor consent. On the contrary, a floating charge will be given over a trading account to circumvent the impracticability of lender consent each time outbound payments need to be made from the account. In this way, the chargor is given the flexibility to continue to use the account for ordinary business purposes until the occurrence of a trigger event (such as a default), at which time the floating charge will crystallise, and attach to all the relevant assets secured by it, including, in the case of bank account charges, any cash held in the chargor's account subject to the charge.

3.6 Can collateral security be taken over shares in companies incorporated in your jurisdiction? Are the shares in certificated form? Can such security validly be granted under a New York or English law-governed document? Briefly, what is the procedure?

The creation of security over shares in a Cyprus company takes the form of a pledge of shares or fixed charge. The most commonly used mechanism is the share pledge which involves the physical delivery to the pledgee of the share certificates representing the pledged shares.

A pledge, as a possessory form of security, creates upon the execution of the relevant security instrument an equitable charge over the shares, and on delivery to the pledgee of the share certificate or certificates representing those shares, a legal charge over the share certificates themselves.

On the borrowers' default, the pledgee is afforded a common law right to sell the pledged assets without recourse to court, provided of course that the security instrument includes a mechanism enabling the pledgee to transfer the pledged shares (using certain aids to enforcement of the pledge which are usually annexed to the charge instrument itself) without additional consent from the pledgor or other formalities or approvals. The aids to enforcement will often include: the original share certificates representing the pledged shares; undated blank instruments of transfer of shares duly executed by the Pledgor; a resolution of the board of directors of the company approving the pledging of the shares and the transfer of such shares on default; and waivers of pre-emption rights (if any).

Unless the terms of the security instrument provide otherwise, the pledgor remains the owner of the pledged shares throughout the life of the pledge and continues to enjoy the rights attaching to the shares in a manner which does not prejudice the rights of the pledgee, until and unless a default event occurs.

Section 138 of the Contract Laws of Cyprus, Cap. 149 as amended, prescribes the formalities required to create a valid and enforceable pledge over the shares of a Cyprus company, namely, it must be signed by the pledgor and made in the presence of two witnesses. Over and above these requirements, section 138(2) sets certain additional requirements for a pledge of shares to be valid and enforceable which include: (i) the giving of notice of pledge by the pledgee to the company in which the shares are pledged; (ii) the company making a memorandum of such pledge in the register of shareholders against the shares in respect of which the notice is given; and (iii) the subsequent delivery by the company of a certificate confirming (iv) above.

Finally, security may also be taken over shares of public companies listed on the Cyprus Stock Exchange. As these shares are in dematerialised form, there will be no "pledge" of the share certificates as such but instead a charge created over the special account of a particular investors' share account which will be registered in the Central Securities Depository and Central Registry of the Cyprus Stock Exchange. A charge over dematerialised securities is valid from the moment of its registration. The requirements of section 138 of the Contract Law do not apply in the case of pledge of dematerialised securities.

Although the security could theoretically be governed by New York or English law, given that the subject matter of the pledge are shares of a Cyprus company, any transfer of those shares to the pledgee or some other third party on enforcement is subject to mandatory provisions of Cypriot law, and will be determined in light of the Companies Laws of Cyprus, as well as the memorandum and articles of association of the Cyprus company concerned.

3.7 Can security be taken over inventory? Briefly, what is the procedure?

Security over inventory usually takes the form of a fixed and floating charge debenture, although a floating charge is the most commonly used form of security due to the constantly fluctuating nature of the asset and the inability of the chargee to exercise control (as in the case of a fixed charge).

3.8 Can a company grant a security interest in order to secure its obligations (i) as a borrower under a credit facility, and (ii) as a guarantor of the obligations of other borrowers and/or guarantors of obligations under a credit facility (see below for questions relating to the giving of guarantees and financial assistance)?

A company may grant a security interest in order to secure its own obligations as borrower or to guarantee the borrowings of a third party. The provision of third party security by a company will, however, be subject to corporate benefit, capacity, solvency and financial assistance issues – see questions 2.2, 2.5, 4.1 and 8.2.

3.9 What are the notarisation, registration, stamp duty and other fees (whether related to property value or otherwise) in relation to security over different types of assets?

Notarisation fees are not applicable in Cyprus.

The Registration fees that will apply in Cyprus are as follows:

(i) Under the Companies Law

Section 90 of the Companies Law provides that every charge (as well as every amendment, assignment or change to it) created by a Cyprus company and conferring security on the company's property or undertaking shall be void against the liquidator and any creditor of the company, unless the prescribed particulars of the charge and a certified copy of the instrument creating it, are delivered to the Registrar of Companies in Cyprus for registration within 21 days after the date of its creation. The prescribed period is extended to 42 days in the case of a charge created by a Cyprus company outside Cyprus, comprising property situated outside Cyprus. Section 90(2) provides an exhaustive list of categories of charge which are capable of registration.

Registration under section 90 of the Companies Law is not a priority point, but a perfection requirement. Registration has the effect of giving public notice of the security to third parties dealing with the company that the particular assets or part of the undertaking has been charged in in the chargee's favour. Failure to register will not affect the validity of the charge as between the parties to it *inter se*; however as mentioned earlier, registration will be necessary to render the security enforceable against any third party creditor or liquidator.

Registration of a charge will incur the payment of filing fees in the region of approx. €680 per charge registered.

Pledges of shares in a Cyprus company are specifically exempted from the ambit of section 90.

Similarly, agreements for the provision of financial collateral which fall within the within the ambit of the Financial Collateral Arrangements Law (Law 43(I) of 2004) are exempted from registration.

Other statutorily prescribed registration fees over specific assets:

Certain additional registration requirements apply in relation to charges over specific classes of assets. A legal mortgage over immovable property requires registration with the District Lands Office Land (see question 3.3). Registration fees of one thousandth of the amount secured are payable. A mortgage over a vessel or any share in a vessel is registered with the Department of Merchant Shipping, with registration fees dependent on the gross tonnage of the vessel (€0.034172 per gross tonne for the first 10,000 tonnes and half that rate above 10,000 tonnes).

(ii) Stamp Duty

Cyprus stamp duty is charged on 'documents' (i.e. agreements or contracts made in writing) relating to assets located in Cyprus and/or matters or things taking place in Cyprus. In general, agreements which do not involve assets situated in Cyprus are generally exempt from stamp duty; however, the final adjudicator on whether or not stamp duty is payable on any document, will be the Commissioner of Stamp Duties.

Stamp Duty is calculated on the value of the agreement and is capped to a maximum amount of €20,000 on the principal document. Any documents relating to the same transaction and which are considered ancillary to the principal document will incur a nominal rate of stamp duty.

Stamp Duty rates:

- €0–€5,000: nil.
- €5,001–€170,000: 0.15%.
- Over €170,000: 0.20%.

Stamp duty must be paid within 30 days from the date of the 'signing' of the relevant document. If for whatever reason the agreement is considered stampable and was not stamped, then a penalty will be payable. Failure to stamp a document which is subject to stamp duty does not invalidate the document of the acts contemplated thereby, but it cannot be adduced as evidence in enforcement proceedings brought before a Cyprus court unless the stamp duty and any penalties for late payment have been paid.

3.10 Do the filing, notification or registration requirements in relation to security over different types of assets involve a significant amount of time or expense?

Filing or registration fees are not significant (see question 3.9 above). In terms of timing, registration occurs upon filing which, in most cases, is a same-day procedure. A certificate of registration of charge (in the case of shares) may be issued by the Registrar of Companies within a matter of days after filing.

3.11 Are any regulatory or similar consents required with respect to the creation of security?

No regulatory or similar consents are needed, although if regulated entities are involved, they may be subject to additional requirements.

3.12 If the borrowings to be secured are under a revolving credit facility, are there any special priority or other concerns?

There are no special priority or other concerns if the borrowings to be secured are under a revolving credit facility.

3.13 Are there particular documentary or execution requirements (notarisation, execution under power of attorney, counterparts, deeds)?

There are specific statutory requirements and formalities that will need to be met in relation to the creation a pledge over shares in a Cyprus company pursuant to the Contract laws of Cyprus, Cap. 149, as amended. See further question 3.6 above.

In the case of deeds, it is no longer a requirement for these to be executed under seal; however if a company chooses to affix its common seal this must be done in accordance with the articles of association of the company.

4 Financial Assistance

4.1 Are there prohibitions or restrictions on the ability of a company to guarantee and/or give security to support borrowings incurred to finance or refinance the direct or indirect acquisition of: (a) shares of the company; (b) shares of any company which directly or indirectly owns shares in the company; or (c) shares in a sister subsidiary?

(a) Shares of the company

Section 53(1) of the Companies Law imposes a prohibition on Cypriot companies to give, whether directly or indirectly, and whether by means of a loan, guarantee, the provision of security or otherwise, any financial assistance for the purpose of or in connection with a purchase or subscription of shares made, or to be made, by any person in the company or in its holding company.

The general prohibition is subject to certain permitted exceptions such as where the lending of money is part of the ordinary business of the company. Similarly, where an otherwise prohibited transaction has been whitewashed under section 53(3), a private company may proceed in giving financial assistance without falling foul of the general prohibition imposed by section 53(1).

The whitewash mechanism requires that (i) the private company concerned is not a subsidiary of a public company registered in Cyprus, and (ii) the transaction has been approved (at any time) by a resolution passed by holders of 90% of all issued voting capital in the company acting in general meeting.

Apart from any action brought against a director for misappropriation of company funds, or breach of duty, any contravention of section 53 (1) will subject the company and every officer to a default fine.

(b) Shares of any company which directly or indirectly owns shares in the company

Yes, see (a) above.

(c) Shares in a sister subsidiary

No prohibition would apply in this scenario.

5 Syndicated Lending/Agency/Trustee/Transfers

5.1 Will your jurisdiction recognise the role of an agent or trustee and allow the agent or trustee (rather than each lender acting separately) to enforce the loan documentation and collateral security and to apply the proceeds from the collateral to the claims of all the lenders?

As a common law jurisdiction, Cyprus law will recognise the role of a security agent or trustee who will hold the security over assets of the borrower on trust for the benefit of a pool of creditors. The duties and responsibilities of the security agent or trustee will be governed by the agency provisions in the loan instrument and the proceeds from enforcement of the loan or collateral security will be administered in accordance with the terms of the intercreditor agreement.

5.2 If an agent or trustee is not recognised in your jurisdiction, is an alternative mechanism available to achieve the effect referred to above which would allow one party to enforce claims on behalf of all the lenders so that individual lenders do not need to enforce their security separately?

Not applicable – see question 5.1.

5.3 Assume a loan is made to a company organised under the laws of your jurisdiction and guaranteed by a guarantor organised under the laws of your jurisdiction. If such loan is transferred by Lender A to Lender B, are there any special requirements necessary to make the loan and guarantee enforceable by Lender B?

There are no special requirements under the laws of Cyprus to make the loan and guarantee enforceable by Lender B, subject to any requirements specified in the loan agreement having been met.

6 Withholding, Stamp and Other Taxes; Notarial and Other Costs

6.1 Are there any requirements to deduct or withhold tax from (a) interest payable on loans made to domestic or foreign lenders, or (b) the proceeds of a claim under a guarantee or the proceeds of enforcing security?

Generally, Cyprus tax legislation does not provide for a withholding tax on interest payable on loans made to domestic or foreign lenders, or the proceeds of a claim under a guarantee or the proceeds of enforcing security.

6.2 What tax incentives or other incentives are provided preferentially to foreign lenders? What taxes apply to foreign lenders with respect to their loans, mortgages or other security documents, either for the purposes of effectiveness or registration?

No specific tax incentives exist for foreign lenders. Generally, foreign lenders are not subject to Cyprus tax or subject to Cyprus withholding tax on any interest payments.

Cyprus Stamp Duty may be applicable on the loan documentation (see the response to question 3.9).

6.3 Will any income of a foreign lender become taxable in your jurisdiction solely because of a loan to, or guarantee and/or grant of, security from a company in your jurisdiction?

A foreign lender is not subject to Cyprus tax solely because of a loan to or a guarantee or security given by a local company.

6.4 Will there be any other significant costs which would be incurred by foreign lenders in the grant of such loan/guarantee/security, such as notarial fees, etc.?

There are no significant costs other than those described in question 3.9 above.

6.5 Are there any adverse consequences for a company that is a borrower (such as under thin capitalisation principles) if some or all of the lenders are organised under the laws of a jurisdiction other than your own? Please disregard withholding tax concerns for purposes of this question.

Cyprus tax legislation does not specifically provide for thin capitalisation or similar rules.

7 Judicial Enforcement

7.1 Will the courts in your jurisdiction recognise a governing law in a contract that is the law of another jurisdiction (a "foreign governing law")? Will courts in your jurisdiction enforce a contract that has a foreign governing law?

The courts of Cyprus will recognise and give effect to a contractual foreign choice of governing law in any action brought before a Cyprus court pursuant to the Rome I Regulation (Reg. (EC) No. 593/2008) regardless of the domicile of the parties (Regulation (EU)

No. 1215/2012 (recast)). The cornerstone of the Regulation is to enshrine the principle of party autonomy and flexibility in respect of choice of law. Where parties choose a foreign governing law which is not the law most closely connected with the contract (assuming this would otherwise be Cypriot law) the courts in Cyprus will tend to give effect to it subject to (i) such choice of foreign law being pleaded and proved, (ii) mandatory provisions of Cypriot law which cannot be derogated from by agreement (penal, revenue and court procedural rules), and (iii) laws which are manifestly inconsistent with public policy.

7.2 Will the courts in your jurisdiction recognise and enforce a judgment given against a company in New York courts or English courts (a "foreign judgment") without re-examination of the merits of the case?

Recognition and enforcement of judgments given by New York courts:

There is no bilateral treaty between Cyprus and the USA on the enforcement of foreign judgments. Although a judgment of a New York court will be recognised under the Recognition, Enforcement and Execution of Foreign Judgments Law, Law 121(I)/2000, enforcement is not immediate. Section 5 of that law sets the procedural requirements to be followed, which commences by way of an application by summons accompanied by an affidavit. The hearing is set four weeks after the date of filing of the application and the respondent is given the right to file an objection (relating to jurisdictional matters and issues of substance).

Recognition and enforcement of judgments given by English courts:

The courts in Cyprus will recognise and enforce judgments issued by English courts in accordance with the Brussels I Regulation (Reg. (EC) No 44/2001) and Regulation (EU) No. 1215/2012 (recast) without any special procedure being required as to its recognition, this being an automatic process. Under the Regulation, a judgment given by the courts of an EU country may not be reviewed as to its substance although a court may refuse to recognise a judgment issued in another Member State under certain limited circumstances (e.g. where it is contrary to public policy). As soon as the judgment is recognised, the competent Cyprus court issues an order for its enforcement and the judgment will be executed as though issued by a Cyprus court.

7.3 Assuming a company is in payment default under a loan agreement or a guarantee agreement and has no legal defence to payment, approximately how long would it take for a foreign lender to (a) assuming the answer to question 7.1 is yes, file a suit against the company in a court in your jurisdiction, obtain a judgment, and enforce the judgment against the assets of the company, and (b) assuming the answer to question 7.2 is yes, enforce a foreign judgment in a court in your jurisdiction against the assets of the company?

The answer is specific to the facts and circumstances of each case and depends on the caseload of the court examining the matter.

7.4 With respect to enforcing collateral security, are there any significant restrictions which may impact the timing and value of enforcement, such as (a) a requirement for a public auction, or (b) regulatory consents?

No. Certain types of borrowers or assets may be subject to their own regulatory requirements and may need prior approval from their respective supervisory authorities.

In exercising the enforcement rights afforded to them under the relevant security documents, a secured creditor is obliged under common law to obtain a fair price when realising assets subject to security and to pay regard to the principle of unjust enrichment.

7.5 Do restrictions apply to foreign lenders in the event of (a) filing suit against a company in your jurisdiction, or (b) foreclosure on collateral security?

Foreign lenders can file a suit against a company in Cyprus and foreclose on collateral security without restriction.

7.6 Do the bankruptcy, reorganisation or similar laws in your jurisdiction provide for any kind of moratorium on enforcement of lender claims? If so, does the moratorium apply to the enforcement of collateral security?

Recent amendments to the Companies Law (Law 62(I) of 2015) have introduced a process of "examinership". The amendments make provision for the appointment of a licensed insolvency practitioner as the "examiner" whose role is to examine the state of the company's affairs and agree restructuring proposals with shareholders during a four-month moratorium, in which the company is considered to be under the protection of the court, and immune from creditor action. Such examiner is appointed pursuant to a petition filed at court and once the court deems that, *inter alia*, a company is unable to pay its debts (i.e. the net asset value of the company is negative, taking into account potential and future liabilities).

Additionally, a court can make an order authorising the examiner to dispose of assets subject to security pursuant to section 202H(1)(d) of the Companies Law if it is satisfied that it would be advantageous to do so. The relevant section provides that where any claim against the company is secured by a mortgage, charge, lien or other encumbrance or a pledge of, on or affecting the whole or any part of the property, no action may be taken to realise the whole or any part of that security, except with the consent of the examiner. Specifically in relation to floating charges an examiner may, by order of the Court, realise the charged property (as if it was not subject to the charge) if in doing so would be to facilitate the survival of the company concerned as a going concern. Any net proceeds from the sale of secured assets pursuant to this section are used first to repay the secured debt with any surplus being distributed among unsecured creditors.

Bankruptcy under the Bankruptcy Law, Cap 5 (as amended by Law 61(I)/2015):

Cypriot courts have the power (in accordance with Cap. 5) to order a 95-day moratorium on any enforcement action by creditors for the purpose of enabling a debtor to agree an arrangement (referred to as a "personal repayment plan") with them. If the plan is approved by a 75% majority of creditors in value and is sanctioned by the court, the arrangement will be binding on the debtor and all creditors. Dissenting creditors are given a right to be heard in court.

7.7 Will the courts in your jurisdiction recognise and enforce an arbitral award given against the company without re-examination of the merits?

As a contracting state to the New York Convention on the Recognition and Enforcement of Foreign Arbitral Awards of 10 June 1958, a Cyprus court will enforce an arbitral award without re-examining the merits, provided that certain requirements as set out in the Convention have been met.

8 Bankruptcy Proceedings

8.1 How does a bankruptcy proceeding in respect of a company affect the ability of a lender to enforce its rights as a secured party over the collateral security?

The main provisions relating to corporate insolvency in Cyprus are contained in the Companies Law (sections 202–305 inclusive) as amended by Law 62(I)/2015. The lender's ability to enforce its rights as a secured party over the collateral security will invariably be affected by its inability to enforce the security during the protected period without the consent of the examiner – see question 7.7.

8.2 Are there any preference periods, clawback rights or other preferential creditors' rights (e.g., tax debts, employees' claims) with respect to the security?

Under section 301 of the Companies Law, any conveyance, mortgage, delivery of goods, payment, execution or other act relating to property made or done by or against a company within six months before the commencement of its winding-up, shall, within the context of a winding up, be considered a fraudulent preference against its creditors and invalid. In determining whether there is a fraudulent preference, the court looks at the dominant intention of giving the creditor a preference over other creditors coupled with a voluntary act made by the company. In establishing whether the intention to defraud existed, the burden of proof will rests with those asserting to avoid the transaction.

Section 303 of the Companies Law provides (in the context of a winding up) that a floating charge on the undertaking or property of the company created within 12 months of the commencement of winding-up shall, unless it is proved that immediately after the creation of the charge the company was solvent, be invalid. The onus of proof rests with the chargee.

Certain claims are treated preferentially in a winding up and will therefore rank ahead of debts secured by a floating charge; namely, the costs of the winding-up and preferential claims, which consist of all government and local taxes and duties due at the date of liquidation (due and payable within 12 months prior to that date) and where there are assessed taxes, taxes not exceeding one whole year's assessment; and all sums due to employees including wages, accrued holiday pay, deductions from wages and compensation for injury.

8.3 Are there any entities that are excluded from bankruptcy proceedings and, if so, what is the applicable legislation?

No, all companies registered in accordance with the Companies Laws will be subject to the insolvency provisions contained therein. Additional requirements will apply to certain regulated entities and companies which carry on business in one or more Member States who will be subject to the provisions of the EU Insolvency Regulation.

8.4 Are there any processes other than court proceedings that are available to a creditor to seize the assets of a company in an enforcement?

Out-of-court proceedings available to a creditor to seize the assets of a company in an enforcement include powers of sale, taking possession, appointment of a manager or receiver and appropriation of financial collateral. The most common practice is for a receiver to be appointed.

9 Jurisdiction and Waiver of Immunity

9.1 Is a party's submission to a foreign jurisdiction legally binding and enforceable under the laws of your jurisdiction?

A party's submission to a foreign jurisdiction is legally binding and enforceable under the laws of Cyprus. See the response to question 7.2 above.

9.2 Is a party's waiver of sovereign immunity legally binding and enforceable under the laws of your jurisdiction?

A party's waiver of sovereign immunity will be legally binding and enforceable under the laws of Cyprus.

10 Licensing

10.1 What are the licensing and other eligibility requirements in your jurisdiction for lenders to a company in your jurisdiction, if any? Are these licensing and eligibility requirements different for a "foreign" lender (i.e. a lender that is not located in your jurisdiction)? In connection with any such requirements, is a distinction made under the laws of your jurisdiction between a lender that is a bank *versus* a lender that is a non-bank? If there are such requirements in your jurisdiction, what are the consequences for a lender that has not satisfied such requirements but has nonetheless made a loan to a company in your jurisdiction? What are the licensing and other eligibility requirements in your jurisdiction for an agent under a syndicated facility for lenders to a company in your jurisdiction?

There are no eligibility requirements in Cyprus in respect of lenders to a Cyprus company.

A lender licensed in their home jurisdiction does not need to be additionally licensed in Cyprus in order to lend funds to a local company.

11 Other Matters

11.1 Are there any other material considerations which should be taken into account by lenders when participating in financings in your jurisdiction?

There are no special considerations that need to be borne in mind by lenders when participating in financings in Cyprus.

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Marinella has over 10 years of post-qualification experience in her chosen practice areas. Marinella started her career in the corporate and commercial department of one of the largest law firms in Cyprus. During her career Marinella has had the opportunity to advise extensively on a number of high-profile blue-chip transactions for a vast range of multinationals and magic-circle law firms.

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E & G Economides LLC, based in Limassol, specialises in Corporate & Commercial, Mergers & Acquisitions, Banking and Finance and Capital Markets work. Litigation, Financial Services and Private Client matters are also offered. With a team currently comprising over 20 advocates, the firm has continued to grow and expand its areas of practice with the support of an active network of global associates with long-standing ties to the corporate and financial communities.

The firm maintains a diverse client base and is regularly instructed by high-net-worth individuals, entrepreneurs, multinational corporations and tax firms, as well as global banking and credit institutions and both domestic and international transactions.

Our clients' interests often have a global focus and we are therefore frequently mandated to co-operate with international law firms on multijurisdictional projects and other cross-border engagements. Such assignments have been pivotal in yielding a globally minded perspective and have brought the firm in close co-operation with international law firms.

Denmark

Thomas Melchior Fischer

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1 Overview

1.1 What are the main trends/significant developments in the lending markets in your jurisdiction?

Interest levels remain historically low and the general market conditions for doing business in Denmark continue to improve as the financial crisis is left behind. Pension funds are in pursuit of a reasonable yield on investments, showing an increased interest in funding large infrastructure projects and corporations, including other alternative investments. Crowdfunding is also rapidly increasing as an alternative source of financing.

1.2 What are some significant lending transactions that have taken place in your jurisdiction in recent years?

The Danish market has been characterised by acquisition finance of M&A transactions rather than significant lending transactions.

2 Guarantees

2.1 Can a company guarantee borrowings of one or more other members of its corporate group (see below for questions relating to fraudulent transfer/financial assistance)?

As a general rule, Danish private and public limited companies may guarantee borrowings of one or more other members of its corporate group provided, in particular, that the corporate benefit requirement is adequately observed (see question 2.2), and that Danish legislation on financial assistance is complied with (see question 4.1).

2.2 Are there enforceability or other concerns (such as director liability) if only a disproportionately small (or no) benefit to the guaranteeing/securing company can be shown?

Under Danish law, it is the directors' duty to ensure that corporate transactions and positions are in the best interest of the company; which often, but not always, mirrors the interest of the shareholders. Put differently, each action of the company must be financially, commercially, or strategically justified. The corporate benefit must accrue to the individual Danish company rather than the corporate group as a whole. In addition to the duty to continuously ensure that the available capital resources are adequate, the corporate benefit requirement entails, for example, that the directors must establish a reasonable balance between the corporate benefit and the risk assumed pursuant to the guarantee.

Under certain circumstances, e.g., in the event of bad faith of the beneficiary, and if the corporate benefit requirement is not duly observed, the guarantee granted by the company may be invalid and unenforceable and the directors may be subject to personal liability for damages and criminal sanctions. Especially in case of a Danish company's granting of upstream or cross-stream guarantees in favour of direct or indirect parent or sister companies, the directors may find it desirable to include limitation language in the guarantee addressing the fulfilment of the corporate benefit requirement.

2.3 Is lack of corporate power an issue?

Lack of corporate power is generally not an issue. In addition to satisfaction of the company's signing powers, lenders usually require a board resolution of the guarantor to minimise potential doubt about lack of corporate power and corporate benefit concerns. Lenders' diligent examinations also include a review of the guarantor's articles of association and publicly available corporate information to ensure among other things that the guarantor's corporate objectives are wide enough to cover the issue of a guarantee.

2.4 Are any governmental or other consents or filings, or other formalities (such as shareholder approval), required?

No; generally, under Danish law, guarantees are not subject to specific formalities.

Broadly speaking, while granting a guarantee is not in the nature of an extraordinary matter to be transacted at the general meeting, in special circumstances the board of directors may find it desirable – even merely as a gesture – to refer such a matter to the general meeting, thereby alleviating disagreement between the shareholders and minimising subsequent shareholder criticism.

2.5 Are net worth, solvency or similar limitations imposed on the amount of a guarantee?

No; however, the directors must at all times ensure that the financial resources of the company are adequate, i.e. that the company has sufficient liquidity to meet its current and future liabilities as they fall due. The duty implies that the directors must assess the company's financial position and ensure that the available capital resources justify the granting of the guarantee. To accommodate directors' liability concerns, limitation language concerning the scope of guarantee is often included.

2.6 Are there any exchange control or similar obstacles to enforcement of a guarantee?

No.

Naturally, it is good practice to examine whether *non-Danish* exchange control or similar obstacles apply.

Denmark enforces 'freezing of funds' and similar financial restrictive measures adopted by the UN and the EU.

3 Collateral Security

3.1 What types of collateral are available to secure lending obligations?

Lending obligations may be secured by a number of different types of security under Danish law, including by way of a pledge, security assignment, mortgage, general floating charge covering specific groups of assets and retention of title. In general, any type of asset may be validly pledged. Furthermore, it is possible not only to agree a negative pledge over certain assets *inter partes* but also to register the negative pledge in the Personal Register whereby it will also have legal effect towards third parties.

3.2 Is it possible to give asset security by means of a general security agreement or is an agreement required in relation to each type of asset? Briefly, what is the procedure?

Danish law does not recognise the concept of a general security agreement covering all assets of the security provider. Each type of asset must be regulated in an individual security agreement or in a combined security agreement incorporating the necessary regulation of each type of security and clearly identifying each individual asset granted as security.

However, a Danish company may provide security by way of a general floating charge over a number of specifically allowed classes of its assets, including trade receivables, inventory, vehicles not previously registered in Denmark, operating equipment and machinery, IPR and goodwill, which is perfected by registration in the Personal Register.

Further, a company operating from a leased property may mortgage its operating equipment, including machines and technical installations.

3.3 Can collateral security be taken over real property (land), plant, machinery and equipment? Briefly, what is the procedure?

Security may be taken over real property by way of real estate mortgages, which are perfected by registration in the Land Register. On properties permanently fitted for a specific business, such mortgage will also cover technical installations, machinery and operating equipment, unless otherwise agreed.

Provided that assets are not covered by a real estate mortgage, security can be taken separately over machinery and operating equipment in the form of a chattel mortgage, which is perfected by registration in the Personal Register or by physical removal of the assets from the pledgor. Similarly, operating equipment and machinery may be mortgaged under a general floating charge. See question 3.2 with respect to granting security over operating equipment and machines of a company operating from a leased property.

3.4 Can collateral security be taken over receivables? Briefly, what is the procedure? Are debtors required to be notified of the security?

Security over receivables can be created by way of a floating charge covering all of the security provider's trade receivables; or by a separate assignment of specific, identified receivables. A floating charge is perfected via registration in the Personal Register and does not require individual notice to the debtors. An assignment on the other hand must be notified to the relevant third party debtor(s); such notice must include an instruction to pay the security holder directly in order for the assignment to be duly perfected.

3.5 Can collateral security be taken over cash deposited in bank accounts? Briefly, what is the procedure?

Security may be taken over cash deposited in a bank account by establishment of a pledge over the bank account. Due perfection requires notification of the pledge to the bank and that the account holder is deprived of all disposal rights to the bank account. Consequently, pledges over bank accounts are impractical with respect to accounts used in a company's day-to-day operations.

3.6 Can collateral security be taken over shares in companies incorporated in your jurisdiction? Are the shares in certificated form? Can such security validly be granted under a New York or English law-governed document? Briefly, what is the procedure?

Shares in unlisted companies can be pledged unless otherwise set out in the company's articles of association. Shares need not be in certificated form in order to be pledged. Provided that the company has not issued negotiable share certificates, the pledge of shares (regardless of whether the shares are certificated or not) is perfected by written notice to the company stating that the share(s) are pledged. Such notice must be provided no later than the time of disbursement of the loan proceeds to avoid risk of claw-back in case of bankruptcy.

If negotiable share certificates have been issued, duly perfection requires that the pledgor is deprived of its physical share certificates. However, physical share certificates are usually not issued by Danish companies.

If the company's shares are issued in dematerialised form through a central securities depositary ("**CSD**"), the pledge is perfected by registration in a Danish CSD (currently only one CSD in Denmark: VP Securities A/S).

A share pledge agreement may be governed by the laws of a foreign jurisdiction, including New York or English laws. However, Danish law would still apply in respect of perfection requirements. Furthermore, Danish law contains certain mandatory duty of care provisions aimed at protecting a pledgor in connection with the enforcement of the security; *cf.* question 7.4. It is therefore advisable and in accordance with market practice in Denmark to have the share pledge agreement governed by Danish law.

3.7 Can security be taken over inventory? Briefly, what is the procedure?

Security over inventory can be created by way of a general floating charge or a separate pledge. A general floating charge is perfected by registration in the Personal Register. A pledge over inventory or stock is perfected by the pledgor being physically prevented from freely disposing of the pledged assets (in Danish: *nøglepant*).

3.8 Can a company grant a security interest in order to secure its obligations (i) as a borrower under a credit facility, and (ii) as a guarantor of the obligations of other borrowers and/or guarantors of obligations under a credit facility (see below for questions relating to the giving of guarantees and financial assistance)?

Yes, subject to the limitations described under questions 2.1, 2.2 and 4.1.

3.9 What are the notarisation, registration, stamp duty and other fees (whether related to property value or otherwise) in relation to security over different types of assets?

There are no notarisation requirements.

As of 1 July 2019, stamp duties have been reduced slightly so that registration of charges and mortgages with the Land Register is subject to stamp duty calculated at 1.45 per cent of the nominal value of the mortgage (to be further reduced to 1.25 per cent by 2026) plus a filing fee of DKK 1,640. Registration of charges and mortgages with the Motor Vehicle Register and the Personal Register are subject to stamp duty calculated at 1.5 per cent of the nominal value of the mortgage plus a filing fee of DKK 1,660. As part of promoting and strengthening maritime activities in Denmark, as of 1 May 2018 the stamp duty of 0.1 per cent of the secured amount in connection with registration of a mortgage over commercial vessels has been abolished.

3.10 Do the filing, notification or registration requirements in relation to security over different types of assets involve a significant amount of time or expense?

No, it involves only limited amount of time and expense, save for security involving registration with the Land Register, the Personal Register or the Motor Vehicle Register, which is subject to stamp duty; see question 3.9.

Registrations with the Land Register, the Personal Register and the Motor Vehicle Register are carried out online, and most often it is possible to obtain a final registration the very same day as the filing is made.

3.11 Are any regulatory or similar consents required with respect to the creation of security?

In general, no regulatory consents are required. Third-party consents pursuant to underlying contracts may need to be considered.

3.12 If the borrowings to be secured are under a revolving credit facility, are there any special priority or other concerns?

No, there are not.

3.13 Are there particular documentary or execution requirements (notarisation, execution under power of attorney, counterparts, deeds)?

If a mortgage requires registration with, for example, the Land Register or the Personal Register, and the digital filing is signed by a person pursuant to a power of attorney, such power of attorney must be prepared in the mandatory format of the Danish Registers and the signature(s) of the principal(s) must be witnessed by two persons.

No other documentary or execution requirements apply.

4 Financial Assistance

4.1 Are there prohibitions or restrictions on the ability of a company to guarantee and/or give security to support borrowings incurred to finance or refinance the direct or indirect acquisition of: (a) shares of the company; (b) shares of any company which directly or indirectly owns shares in the company; or (c) shares in a sister subsidiary?

(a) Shares of the company

According to the general rule set forth in the Companies Act, a private or public limited company may not, directly or indirectly, advance funds, grant loans, or provide security (including guarantees) for a third party's acquisition of (or subscription for) shares of that company or of its parent company (i.e. a prohibition against financing of purchase of own shares).

This general prohibition does, however, not apply if certain requirements concerning the following matters are met: (i) shareholder approval; (ii) the proposed transaction is advisable considering the company's financial position or, if it is a parent company, its consolidated financial position; (iii) a report by the central management body to be publicly registered with the Danish Business Authority; and (iv) the proposed transaction is entered into on market terms including preparation of a credit rating of the purchaser and, if relevant, the financier.

Furthermore, the general prohibition does not apply to banks or mortgage loans granted by mortgage credit institutions or to transactions for the acquisition of shares to or from the employees of the company or any subsidiary.

Certain post-financing situations regarding acquisition of companies have been held to be unlawful by the Danish Business Authority, although such matters in themselves could be seen as justified corporate actions.

(b) Shares of any company which directly or indirectly owns shares in the company

The general prohibition including exceptions referred to under question 4.1 (a) also apply to a company's, direct or indirect, purchase of (or subscription for) shares in a parent company and presumably also in an indirect parent company.

(c) Shares in a sister subsidiary

Danish law does not stipulate any prohibition on financial assistance provided for the purchase of (or subscription for) shares in a sister subsidiary.

5 Syndicated Lending/Agency/Trustee/Transfers

5.1 Will your jurisdiction recognise the role of an agent or trustee and allow the agent or trustee (rather than each lender acting separately) to enforce the loan documentation and collateral security and to apply the proceeds from the collateral to the claims of all the lenders?

Yes. Lenders may appoint agents, including security agents under the loan documentation, and such agents may enforce the rights of the lenders and apply the proceeds from the security to the claims of all the lenders; *cf.* chapter 4 of the Danish Capital Markets Act, which entered into force on 3 January 2018.

5.2 If an agent or trustee is not recognised in your jurisdiction, is an alternative mechanism available to achieve the effect referred to above which would allow one party to enforce claims on behalf of all the lenders so that individual lenders do not need to enforce their security separately?

See question 5.1.

5.3 Assume a loan is made to a company organised under the laws of your jurisdiction and guaranteed by a guarantor organised under the laws of your jurisdiction. If such loan is transferred by Lender A to Lender B, are there any special requirements necessary to make the loan and guarantee enforceable by Lender B?

The guarantee will often be granted in favour of the lenders from time to time and state that the guarantor's obligations are not reduced or discharged as a consequence of any transfer by a lender of its rights, in which case the loan and guarantee are enforceable by Lender B without further notice to the guarantor or other actions.

In the absence of such provisions in the guarantee, Lender B's enforcement of any rights under the loan requires that the borrower is notified of the transfer. In general, a guarantee in respect of a loan obligation will continue to apply and may be called upon by any new lender that has validly acquired the loan that is being guaranteed. However, the guarantor must be notified of the transfer in order to avoid the risk of the guarantor fulfilling its guarantee obligation by payment to the initial lenders or third parties.

6 Withholding, Stamp and Other Taxes; Notarial and Other Costs

6.1 Are there any requirements to deduct or withhold tax from (a) interest payable on loans made to domestic or foreign lenders, or (b) the proceeds of a claim under a guarantee or the proceeds of enforcing security?

Apart from the obligation of a Danish borrower to withhold tax at source from interest payments to a foreign lender, *cf.* question 6.3, there are no requirements to deduct or withhold tax under Danish law.

6.2 What tax incentives or other incentives are provided preferentially to foreign lenders? What taxes apply to foreign lenders with respect to their loans, mortgages or other security documents, either for the purposes of effectiveness or registration?

No tax incentives or other incentives are provided preferentially to foreign lenders.

Provided that no permanent establishment in Denmark exists with which the income from the loan, guarantee or security interest is effectively connected, no taxes apply to foreign lenders in such cases; *cf.* question 3.9 with respect to applicable stamp duties.

6.3 Will any income of a foreign lender become taxable in your jurisdiction solely because of a loan to, or guarantee and/or grant of, security from a company in your jurisdiction?

No. Tax liability requires, as a general rule, that the foreign lender has a permanent establishment in Denmark. Similarly, loan interest income secured on real property does not in itself lead to tax liability.

Interest payments and capital gains received by a foreign lender deriving from a loan to a Danish borrower may, however, be subject to withholding tax at source regarding certain intra-group loans (22 per cent of the total interest amount) if not otherwise provided by, for example, applicable double taxation agreements, or EU Directive 2003/49 on a common system of taxation applicable to interest and royalty payments made between associated companies of different EU Member States.

6.4 Will there be any other significant costs which would be incurred by foreign lenders in the grant of such loan/guarantee/security, such as notarial fees, etc.?

See question 3.9.

6.5 Are there any adverse consequences for a company that is a borrower (such as under thin capitalisation principles) if some or all of the lenders are organised under the laws of a jurisdiction other than your own? Please disregard withholding tax concerns for purposes of this question.

Danish tax law includes a number of deductibility limitation rules to be applied in the order given below: (1) the 'thin capitalisation' rule; (2) the 'interest-rate ceiling' rule; and (3) the 'EBITDA' rule.

<u>The 'thin capitalisation' rule</u>

The thin capitalisation rule entails that thin capitalised companies' ability to deduct interest and capital loss on controlled loans is limited. The thin capitalisation rule only kicks in if the controlled debt exceeds DKK 10 million and the lender(s) is/are not a natural person. It includes back-to-back structures involving third-party lenders, e.g. banks. The thin capitalisation rule presupposes (i) a debt-to-equity ratio of four to one at the end of the income year, i.e. that the debt of the company exceeds the equity of the company by more than four times, (ii) that the company does not prove that a similar financing can be obtained between independent parties, and (iii) that the interest costs are not covered by interest withholding tax at source. Any interest on debt to related parties in excess of this ratio will be subject to deductibility reduction. A recent amendment of the 'thin capitalisation' rule adopted by Danish legislators to rectify EU law conformity took effect on 1 January 2019 and applies to the income year 2018 and onwards. According to this amendment, interests and capital gains are not included in the statement of the taxable income of a Danish company (or of permanent establishment in Denmark) if the debtor is resident in another EU or EEA Member State and could not deduct corresponding amounts under the 'thin capitalisation' rule had the debtor been subject to Danish tax. Furthermore, it is a condition for the 'thin capitalisation' rule to apply that the debtor under the 'thin capitalisation' rule in the other country has not obtained a deduction for similar amounts.

<u>The 'interest-rate ceiling' rule</u>

The 'interest-rate ceiling' rule entails that a company's access to deduct net financing expenses is reduced. Unlike the thin capitalisation rule, this rule also has an impact on debt to independent lenders. The deductibility reduction caused by the 'interest-rate ceiling' entails that the net financing expenses are only deductible to the extent that they do not exceed the tax value of the company's assets multiplied by a standard rate of return. This deductibility reduction rule only applies to the net financing expenses exceeding DKK 21.3 million.

The 'EBITDA' rule

Applicable to financial years commencing as of 1 January 2019, the new EBITDA rule replaces the existing EBIT rule. According to the new EBITDA rule, companies may not deduct so-called 'exceeding borrowing costs' exceeding 30 per cent of the company's taxable income before 'exceeding borrowing costs' and deductions (EBITDA). 'Exceeding borrowing costs' are defined as the amount by which the deductible borrowing costs exceed taxable interest revenues and other economically equivalent taxable revenues, i.e. similar to the definition of the net financing expenses; *cf.* the 'interest-rate ceiling' rule. The 'EBITDA' reduction rule applies only to deductible interest amounts exceeding DKK 22,313,400 (EUR 3,000,000). Net financing expenses restricted under the EBITDA rule may be carried forward for tax deduction in the following years. Special rules apply to affiliated companies and financial companies.

7 Judicial Enforcement

7.1 Will the courts in your jurisdiction recognise a governing law in a contract that is the law of another jurisdiction (a "foreign governing law")? Will courts in your jurisdiction enforce a contract that has a foreign governing law?

Danish courts will generally recognise the law of a foreign jurisdiction as the governing law in a contract and enforce the provisions of such contract with the exception of any provisions contrary to Danish public policy.

The current "Brexit" situation, however, gives rise to legal uncertainty in respect of contractual relations involving parties based in Denmark and the UK concerning choice of law and jurisdiction issues.

7.2 Will the courts in your jurisdiction recognise and enforce a judgment given against a company in New York courts or English courts (a "foreign judgment") without re-examination of the merits of the case?

A foreign judgment rendered in the courts of a country which is not a contracting state under: (i) the Council Regulation (EC) No 1215/2012 on jurisdiction and the recognition and enforcement of judgements in civil and commercial matters, as amended, and implemented in Danish law; (ii) the Brussels Convention of 27 September 1968; (iii) the revised Lugano Convention of 30 October 2007; or (iv) the Hague Convention of 30 June 2005 on Choice of Court Agreements, would not be recognised or enforceable in Denmark without a retrial on the merits. Accordingly, a judgment rendered by a New York court would not be enforceable in Denmark.

A foreign judgment rendered by a court in any EU Member State, e.g. England, or any country that is a party to the abovementioned conventions, will be recognised and enforceable by the Danish courts in accordance with the provisions of the Council Regulation, the Brussels Convention, the revised Lugano Convention and the Hague Convention, respectively.

The mutual recognition of judgments between Danish and UK courts following the "Brexit" situation still remains unclear.

7.3 Assuming a company is in payment default under a loan agreement or a guarantee agreement and has no legal defence to payment, approximately how long would it take for a foreign lender to (a) assuming the answer to question 7.1 is yes, file a suit against the company in a court in your jurisdiction, obtain a judgment, and enforce the judgment against the assets of the company, and (b) assuming the answer to question 7.2 is yes, enforce a foreign judgment in a court in your jurisdiction against the assets of the company?

The duration of the legal proceedings will depend on which Danish court determines the case. If the Copenhagen City Court is the court of first instance, we estimate that it will take approximately 9–12 months to obtain an enforceable judgment. If the loan agreement satisfies the requirements for a debt instrument (in Danish: *gældsbrev*) and includes a clause of immediate enforceability, claims under the loan agreement may be enforced directly by the lender by application to the Bailiff's Court (in Danish*: fogedretten*) without having to obtain a judgment beforehand; *cf.* question 8.4.

Unless otherwise stated in the judgment and subject to the debtor's appeal of the judgment which may suspend the lenders' right to enforce the judgment, a judgment will become enforceable 14 days after the date of the ruling. Enforcement is carried out through the Bailiff's Court under the relevant district court by written application to the Bailiff's Court with the objective to seize the assets of the debtor and sell these via a forced sale. This procedure will likely take two to three months.

A similar duration of the enforcement process should be expected with respect to enforcement of foreign judgments if the Council Regulation applies, i.e. with respect to judgments rendered by a competent court of another EU Member State (see question 7.2).

7.4 With respect to enforcing collateral security, are there any significant restrictions which may impact the timing and value of enforcement, such as (a) a requirement for a public auction, or (b) regulatory consents?

In general, a creditor is free to enforce a pledge in accordance with the enforcement provisions of the pledge agreement without having to obtain a judgment provided that the pledgor is given one week's prior written notice to satisfy the claim and the loan agreement satisfies the requirements for immediate enforceability.

Notwithstanding the above, enforcement of certain types of security, for example, real estate mortgages, floating charges and dematerialised shares issued through a CSD, must be carried out in accordance with specific, statutory procedures set out in the Administration of Justice Act and the Capital Markets Act, including certain provisions regarding public auctions that may impact the timing of the enforcement. Further, a secured creditor is subject to a general duty of care obligation and obliged to look after the interests of the pledgor when enforcing security interests. No regulatory consents are otherwise required; see, however, section 8 regarding bankruptcy proceedings.

7.5 Do restrictions apply to foreign lenders in the event of (a) filing suit against a company in your jurisdiction, or (b) foreclosure on collateral security?

If required by an EU or EFTA defendant (i.e. including a Danish defendant), a foreign plaintiff not domiciled in an EU or EFTA country must furnish security for the legal costs that he might be obliged to pay as a result of the proceedings, unless such plaintiff resides in a country having entered into a bilateral treaty with Denmark permitting a plaintiff residing in Denmark to bring a legal claim against a person in that country without having to furnish security.

In general, no restrictions apply to foreign lenders in the event of foreclosure on security.

7.6 Do the bankruptcy, reorganisation or similar laws in your jurisdiction provide for any kind of moratorium on enforcement of lender claims? If so, does the moratorium apply to the enforcement of collateral security?

The Bankruptcy Act contains certain limitations on secured creditors' access to enforce security during the period when an insolvent company is taken under reconstruction proceedings. Reconstruction proceedings may be initiated by the insolvent company or any of its creditors. However, if more than 50 per cent of the creditors (based on the amounts owed to these) present at the first creditors' meeting do not support the proposed reconstruction plan and the opposing creditors constitute no less than 25 per cent of the company's total known debt, the reconstruction proceedings will immediately be terminated. See also question 8.1.

7.7 Will the courts in your jurisdiction recognise and enforce an arbitral award given against the company without re-examination of the merits?

Yes. Foreign awards based on an arbitration agreement are recognised and enforced in Denmark in accordance with the New York Convention as ratified by Denmark in 1972.

8 Bankruptcy Proceedings

8.1 How does a bankruptcy proceeding in respect of a company affect the ability of a lender to enforce its rights as a secured party over the collateral security?

Secured claims are covered prior to the statutory ranking of creditors. To the extent the value of the asset granted as security does not cover the secured claim, any uncovered part of the claim will be subject to the statutory ranking of creditors.

If the lender's claim is secured by way of a pledge (in Danish: *håndpant*) or other corresponding security interest, including a floating charge on claims (in Danish: *virksomhedspant*) or receivables charge (in Danish: *fordringspant*), the secured lender is entitled to enforce its claim independently of the bankruptcy estate.

As for other claims secured by real estate mortgage or chattel mortgage, such ordinary claims are enforced in cooperation with the bankruptcy estate. Where the estate has not made a petition for a forced sale within six month from the date of the bankruptcy order, any mortgagee with an overdue claim may demand that the estate conducts a forced sale without undue delay.

Effective as of the time of the decree of the bankruptcy proceedings, unsecured creditors cannot levy execution on the property of the insolvent debtor.

8.2 Are there any preference periods, clawback rights or other preferential creditors' rights (e.g., tax debts, employees' claims) with respect to the security?

The Bankruptcy Act includes clawback provisions which effectively set aside certain transactions executed during the period leading up to the bankruptcy proceedings provided, among other things, that:

- The transaction was made to the detriment of the creditors or result in fraudulent preference of some creditors over other creditors (e.g. in the form of presents, renunciation of inheritance, wages and other remuneration for work, early repayment of debt, provision of security without new credit being granted, etc.).
- The transaction took place after or within a specified period before the commencement of bankruptcy; i.e. within three months, six months, or – in case of related parties and provided that the burden of proof of solvency at the time of the transaction is not met or, pursuant to a recent amendment to the Bankruptcy Act taking effect on 1 January 2018, if the recipient of a gift cannot prove that the debtor undoubtedly kept sufficient assets to cover its liabilities – up to one year or two years.
- The relevant point in time to be considered when assessing if a security interest may be avoided is the time of perfection of the security interest.

In addition, the clawback provisions include an avoidance rule not limited in time applicable in the event that the debtor was or became insolvent as a consequence of the transaction and the preferred party knew or should have known of the debtor's insolvency and the circumstances causing the transaction to be fraudulent.

The said recent amendment to the Bankruptcy Act, which applies to presents granted as of 1 January 2018, expands the possibility of declaring void certain presents. By way of example, presents which are grossly disproportionate to the debtor's financial situation can be set aside even if the present was granted prior to the specified periods described above.

8.3 Are there any entities that are excluded from bankruptcy proceedings and, if so, what is the applicable legislation?

No. All natural persons and legal entities may be subject to bankruptcy proceedings.

Public authorities such as municipal authorities are excluded from bankruptcy proceedings.

As for enterprises the debts of which members are personally liable, e.g. a partnership (in Danish: *interessentskab*) or a limited partnership (in Danish: *kommanditselskab*), a bankruptcy procedure may only be initiated if *all* such members have been declared bankrupt.

8.4 Are there any processes other than court proceedings that are available to a creditor to seize the assets of a company in an enforcement?

If a creditor is in possession of a basis of enforcement (in Danish: *eksekutionsgrundlag*), e.g. a judgment, settlement, or certain mortgages, the creditor may take the claim directly to the Bailiff's Court, without the need to obtain prior judgment, in order to enforce the security through the Bailiff's Court.

9 Jurisdiction and Waiver of Immunity

9.1 Is a party's submission to a foreign jurisdiction legally binding and enforceable under the laws of your jurisdiction?

In general, a party's submission to a foreign jurisdiction will be legally binding and enforceable under Danish law, subject to certain exceptions regarding consumers and employees.

9.2 Is a party's waiver of sovereign immunity legally binding and enforceable under the laws of your jurisdiction?

Yes, save for matters specifically protected by international law, e.g. diplomatic immunity and assets protected by diplomatic immunity or other provisions under international law.

10 Licensing

10.1 What are the licensing and other eligibility requirements in your jurisdiction for lenders to a company in your jurisdiction, if any? Are these licensing and eligibility requirements different for a "foreign" lender (i.e. a lender that is not located in your jurisdiction)? In connection with any such requirements, is a distinction made under the laws of your jurisdiction between a lender that is a bank *versus* a lender that is a non-bank? If there are such requirements in your jurisdiction, what are the consequences for a lender that has not satisfied such requirements but has nonetheless made a loan to a company in your jurisdiction? What are the licensing and other eligibility requirements in your jurisdiction for an agent under a syndicated facility for lenders to a company in your jurisdiction?

There are no licensing or other eligibility requirements in Denmark for Danish or non-Danish lenders. Granting loans without receiving deposits from the public does not in itself require authorisation. This also applies to Danish and non-Danish (security) agents under a syndicated facility. If other categories of financial activities are to be conducted, this may be subject to authorisation/licence and supervision by the Danish FSA. A financial institution, e.g. a bank or a mortgage credit institution, which is subject to the Financial Business Act, may by way of example not carry out activities until it has obtained a designated authorisation/licence from the Danish FSA.

11 Other Matters

11.1 Are there any other material considerations which should be taken into account by lenders when participating in financings in your jurisdiction?

No, there are no other material considerations which should be taken into account.

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Located in the centre of Copenhagen, Nielsen Nørager Law Firm LLP advises international and Danish clients on complex commercial transactions within finance and banking, corporate and commercial, debt and equity capital markets, private and public M&A, IPOs, securities regulation, venture and private equity, tax, and a number of other practice areas.

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Chapter 48

England

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1 Overview

1.1 What are the main trends/significant developments in the lending markets in your jurisdiction?

The United Kingdom issued formal notice of its intention to leave the European Union in March 2017, commencing the two-year period officially allocated by the EU treaties to finalise Brexit. UK and European loan markets initially seemed relatively unaffected by the UK's impending departure from the EU. However, in late 2018/early 2019 there are definite signs of momentum slowing in UK lending, due to the continued uncertainty as to the likely outcome of the Brexit negotiations and the possibility that the UK and EU will fail to agree the terms of a relationship after Brexit (the so-called "no deal" exit, leaving the UK trading on World Trade Organisation terms and having no preferential arrangements for customs clearance, etc. with the EU). Unless further legislation is passed to delay Brexit (which is a distinct possibility, although politically charged), the UK will cease to be a member of the EU at 11pm (UK time) on 29 March 2019.

English law continues to be the choice for the vast majority of cross-border European deals (whether or not there is any connection with England): the UK's departure from the EU has no significant effect on English contract law, which does not derive from European law or on the approach of EU Member States or the UK to respecting English governing law clauses. The position in relation to English jurisdiction clauses is more complex, but English jurisdiction clauses nevertheless remain the preferred option for the majority of cross-border deals.

The trends of robust liquidity, low interest rates and fierce competition for lending mandates have continued. This, coupled with a buoyant leveraged/private equity market and a steady flow of M&A activity, has meant continued attractive pricing terms for borrowers and sponsors. Strong investment grade borrowers also continue to dictate favourable documentation terms, and continuing competition for lending in the mid-market and cross-over space also means terms drifting in borrowers' favour. The corporate lending market remains strong overall (despite the pause in the immediate run-up to Brexit) and, although there is a trend to diversify funding away from banks to other sources, bank lending remains the first choice for event-driven financing such as M&A due to its deep liquidity and the speed and confidentiality with which finance can be arranged. In the leveraged market, covenant-lite structures remain prevalent and although there are similar headwinds to investment grade markets, confidence remains strong.

It is widely expected that LIBOR, the reference rate on which almost all sterling and UK dollar lending is based, will be discontinued after 2021 and replaced with new risk-free rates which will meet regulatory expectations of transparency and objectivity. Industry groups and regulators are currently working on proposals for new rates and it is likely that there will be a shift to those new rates during 2019. As yet there is little change in documentation, other than to make it easier (from a process perspective) to amend transactions to reflect these new rates when the parties with to do so. European markets are almost universally adopting an "amendment" approach to benchmark change, rather than the hard-wired approach being considered in the US.

1.2 What are some significant lending transactions that have taken place in your jurisdiction in recent years?

Informa Plc's acquisition of UBM Plc was supported by a GBP2bn syndicated loan facility. Smurfit Kappa Corporation Limited raised a new GBP1.3bn syndicated facility for general corporate purposes and refinancing of its existing debt. Dalmore Capital and Equitix Investment Management's successful public bid for John Laing Infrastructure Fund was part financed by a GBP1.4bn syndicated loan facility.

In the leveraged market, KKR's successful acquisition of Unilever's baking, cooking and spreads business, Flora Food Group, was financed by a EUR3.95bn senior term loan and EUR1.1bn high-yield financing. Macquarie Infrastructure's public bid for TDC A/S, a publicly listed Danish telecommunications company, was supported by a EUR7.09bn senior loan and notes financing.

The above facilities, in each case documented under English law, highlight the depth of the syndicated loan markets in the UK and Europe and the continuing relevance of English law in cross-border M&A transactions and the European loan markets more generally.

2 Guarantees

2.1 Can a company guarantee borrowings of one or more other members of its corporate group (see below for questions relating to fraudulent transfer/financial assistance)?

Generally yes, provided there is adequate corporate benefit (which need not be direct financial benefit but can include less tangible factors such as management support) and the company has the legal capacity to give the guarantee (which almost all do).

2.2 Are there enforceability or other concerns (such as director liability) if only a disproportionately small (or no) benefit to the guaranteeing/securing company can be shown?

In general, directors are required to act in good faith and have a duty to promote the success of the company for the benefit of its members as a whole. In normal circumstances, where directors form a view that giving the guarantee promotes the success of the company because of the benefits to the borrower, guarantees for no direct benefit are valid. Downstream guarantees are generally no problem; for upstream or cross-stream guarantees it is necessary for the director to apply more thought to these matters. On the other hand, if the company is of doubtful solvency and a long-term view is unrealistic, this duty is displaced with a duty to have regard to the interests of the creditors of the company (taking precedence over the interests of members). If there is no reasonable prospect that the company can avoid insolvent liquidation or administration, directors should also be mindful of wrongful trading liability. In certain circumstances, a guarantee may be set aside as a preference or due to the insolvency of the company (see question 8.2).

Commentary in 2017 by the Institute of Chartered Accountants of England and Wales questioned whether a company ought to be able to ascribe no liability, in the Company's accounts, to a guarantee given in respect of a parent company even if the directors assess that there is a low likelihood of the parent company failing to pay and the guarantee being called. Although this view is discussed occasionally, particularly if a company is near insolvency, for most transactions this is seen as an academic debate and market practice has not changed.

2.3 Is lack of corporate power an issue?

Lack of corporate power would not necessarily make a guarantee void; however, the capacity of a company to enter into a guarantee should be checked by looking at its memorandum (if any) and articles of association. The company's objects will often include an express power to grant guarantees, but even if this is not expressly stated then the objects may be wide enough to cover granting guarantees if that is ancillary to the business.

2.4 Are any governmental or other consents or filings, or other formalities (such as shareholder approval), required?

Generally no; however, there may be particular requirements in the case of regulated entities. A shareholder resolution is also often provided to mitigate corporate benefit concerns.

A guarantee is required to be in writing, signed by the guarantor.

Standalone guarantees are often executed as a deed to avoid any arguments regarding due consideration.

2.5 Are net worth, solvency or similar limitations imposed on the amount of a guarantee?

No, although directors should consider the solvency of the company as part of promoting its success and best interests.

2.6 Are there any exchange control or similar obstacles to enforcement of a guarantee?

No, although it is prudent to check whether non-English exchange control or sanctions considerations will apply to a guarantee given by a non-UK company or which relies on recourse to non-UK assets.

Guarantees (and other obligations) of state entities may benefit from sovereign immunity.

3 Collateral Security

3.1 What types of collateral are available to secure lending obligations?

It is possible to take security over all types of assets of an English company.

3.2 Is it possible to give asset security by means of a general security agreement or is an agreement required in relation to each type of asset? Briefly, what is the procedure?

Security over all or substantially all of a company's assets may be given by a single document, known as a debenture (not the same as a fixed income share of a company, which confusingly is also known as a debenture).

A debenture usually includes:

(a) a fixed charge over assets which are identifiable and can be controlled by the creditors (e.g. restricted accounts);

(b) a floating charge which is used to capture fluctuating and less identifiable assets (e.g. inventory);

(c) an assignment of receivables and contracts; and

(d) mortgages over real estate and shares.

If the debenture includes a real estate mortgage or a power of attorney, it must be executed as a deed (see question 3.13). In practice, all security documents are almost always executed as deeds.

There is no universal registration of perfection (like UCC filings in the United States), so perfection of security over assets is required depending on the type of asset (see questions 3.3 to 3.7). Consideration should also be given to whether additional formalities or documents should be used when securing assets of an English company which are not based in England or when taking security over particular types of assets, e.g. ships, aircraft, or chattels which are moveable.

Security by real persons is also possible, on largely similar terms.

3.3 Can collateral security be taken over real property (land), plant, machinery and equipment? Briefly, what is the procedure?

Security over land is ideally taken by way of a legal mortgage. A legal mortgage transfers legal title to the creditor and restricts the chargor from taking certain actions while the asset is subject to the mortgage, e.g. disposing of or mortgaging the asset further without consent. A legal mortgage cannot be granted over future acquired assets.

It is also possible to create an equitable mortgage over land where the beneficial title in the land is transferred to the creditor but legal title remains with the chargor. We often see an equitable mortgage where the parties have agreed that a legal mortgage will only come into effect if certain events occur or where the formalities required for a legal mortgage cannot be met. An equitable mortgage suffers from certain disadvantages compared to a legal mortgage but, except in the case of fraud by the chargor, these disadvantages are often accepted.

When taking security over land, consider whether the chargor is required to obtain third party consents (for example from the freeholder if security relates to leasehold title). Security should be registered with the Land Registry in most circumstances.

Security over plant, machinery and equipment may be caught by a legal mortgage over the land if those assets are sufficiently attached to the mortgaged land; however, a fixed charge is usually granted over these types of assets. A fixed charge is generally only used for identifiable assets and where a creditor is able to show sufficient control over the asset. There are no specific documentation formalities required for creating a fixed charge, although for moveable assets and other types of asset, it may be advisable to affix some sort of notice to the asset to give third parties notice of the security.

3.4 Can collateral security be taken over receivables? Briefly, what is the procedure? Are debtors required to be notified of the security?

Yes, usually by way of an assignment (subject to such receivables being assignable) but can also be covered by a fixed charge (see question 3.2 above) or a floating charge (see question 3.5 below).

An assignment of receivables can be legal or equitable. A legal assignment must be in writing, signed by the assignor, absolute (unconditional and irrevocable) and notice must be given to the relevant third parties. If any of these conditions are not met then the assignment will be an equitable assignment. The main benefits of a legal assignment are (a) the creditor can sue in its own name (if it is an equitable assignment the creditor would have to join the assignor as a third party to any suit), and (b) the third party (once notice has been served) will only be able to discharge its obligations to, or as directed by, the creditor.

It is common for certain assignments to be equitable assignments until a trigger event occurs and the assignor is then required to give notice to the third party (and the legal assignment is perfected), but this is dependent upon negotiation. Acknowledgment of the notice by the third party is often requested but does not affect the nature or validity of the assignment.

3.5 Can collateral security be taken over cash deposited in bank accounts? Briefly, what is the procedure?

Yes, by a fixed or floating charge.

A fixed charge over a bank account is generally only effective where the account is blocked such that the chargor can only make withdrawals with the creditor's permission. A floating charge allows the chargor to continue to deal with the account in the ordinary course until there is a trigger event (usually a default), at which point the creditor may notify the account bank that it controls the account. A trading account would only be subject to a floating charge, as the business would need constant access to the account and seeking lender consent would be impractical.

Whether a charge is fixed or floating will be dependent on the level of control the creditor has over the account. A floating charge ranks below certain other claims in an insolvency, such as a ring-fenced fund for unsecured creditors and (more importantly in large transactions) expenses of the liquidation or administration.

3.6 Can collateral security be taken over shares in companies incorporated in your jurisdiction? Are the shares in certificated form? Can such security validly be granted under a New York or English law governed document? Briefly, what is the procedure?

Shares in English companies are required to be registered (not bearer) and may be certificated or uncertificated (and/or held in a clearing system).

Security over shares in an English company should be effected by an English law security document.

Shares are usually charged by way of a mortgage or fixed charge. A legal mortgage over certificated shares involves transferring ownership of the shares to the creditor and registering the creditor in the shareholder register. The share certificate in the chargor's name will be cancelled and replaced with one in the creditor's name. A legal mortgage allows the lender to vote the shares, receive any dividends and any information about the shares until the debt is discharged.

Often an equitable mortgage is granted subject to the creditor being able to create a legal mortgage if certain trigger events occur. This is achieved by delivering share certificates and a signed but undated stock transfer form to the creditor. If the security becomes enforceable the creditor can complete the undated stock transfer form and any formalities required to become legal holder of the shares. Prior to the security being enforceable all voting rights, dividends and any communication about the shares will remain with the chargor.

Uncertificated shares can be secured by an equitable or legal mortgage. In order to hold uncertificated shares, the creditor will need a securities account with the clearing system (or with a financial institution which has such an account). A legal mortgage will be perfected by an instruction to the clearing system to transfer the shares to the securities account of the creditor.

An equitable mortgage of shares in a clearing system is created by depositing the shares into an escrow account with the clearing system and restricting withdrawals without the creditor's permission.

If a legal mortgage over shares is taken and perfected so that the shares are transferred to the mortgage, then the mortgagee is likely to become a "person with significant control" (PSC) under the PSC regime. The mortgage will then be subject to legal obligation to provide information about itself to the mortgagor. That information will become public information. Failure to provide this information is a criminal offence. These obligations do not arise under an equitable mortgage (which is the more common approach to share security) so are not usually a concern.

When taking security over companies subject to the PSC regime, mortgagees should ensure that they are protected against the risk of a restrictions notice being issued (under the PSC regime) in respect of the shares. A restrictions notice effectively freezes the interest so the security cannot be enforced, dividends cannot be paid nor voting rights exercised. Protection against this risk requires market standard PSC provisions to be included in the credit or security agreement.

Other considerations include: stock exchange notification requirements; tax implications; and restrictions in the company's constitutional documents (such as liens, pre-emption rights or a right to refuse to register a transfer).

3.7 Can security be taken over inventory? Briefly, what is the procedure?

Yes. Typically a floating charge is most appropriate given the fluctuating nature of inventory and the inability of a secured creditor to exercise sufficient control for a fixed charge. See question 3.5 above.

3.8 Can a company grant a security interest in order to secure its obligations (i) as a borrower under a credit facility, and (ii) as a guarantor of the obligations of other borrowers and/or guarantors of obligations under a credit facility (see below for questions relating to the giving of guarantees and financial assistance)?

Yes, subject to corporate benefit and solvency considerations similar to those for a guarantee (see questions 2.1 to 2.3 above).

3.9 What are the notarisation, registration, stamp duty and other fees (whether related to property value or otherwise) in relation to security over different types of assets?

Registration requirements depend on the type of secured asset. The majority of security interests created by an English company must be registered at Companies House within 21 days of its creation. Failure to register within this time means that the security will be void against the liquidator, administrator or any creditor of the company and the money secured by the security becomes immediately payable.

A prescribed form must be completed to register a company's security along with supporting documentation and payment of a fee (£23 paper filing or £15 online filing). This registration is a statutory requirement but is not a universal perfection filing (like UCC in the United States) – it does not remove the need to perfect security over specific assets.

Security over English real estate must be registered at the land registry and security over certain other assets, such as IP, ships and aircraft, needs to be registered at applicable registries.

Security by real persons over certain types of moveable asset may require registration as a bill of sale.

There are no notarisation requirements for security documents under English law.

See question 6.2 regarding stamp duty.

3.10 Do the filing, notification or registration requirements in relation to security over different types of assets involve a significant amount of time or expense?

No, prescribed forms need to be completed (see question 3.9 above) and minor fees need to be paid.

3.11 Are any regulatory or similar consents required with respect to the creation of security?

Generally no; however, consider requirement for third-party consents under underlying contracts. Additional consents may be required if involving regulated entities or assets.

3.12 If the borrowings to be secured are under a revolving credit facility, are there any special priority or other concerns?

Generally, no.

3.13 Are there particular documentary or execution requirements (notarisation, execution under power of attorney, counterparts, deeds)?

Creditors generally expect to receive board and/or shareholder minutes approving the documentation for evidentiary purposes and to ensure corporate benefit issues have been considered.

A legal mortgage over land must be in writing, signed by all parties, incorporate all terms expressly agreed and fulfil the requirements of a deed.

A deed must be in writing, clear from its face that it is a deed, validly executed as a deed and must be delivered.

Security agreements usually contain a power of attorney and therefore will need to be executed as a deed.

Other guidelines should be considered, such as law society practice notes and recent case law which states that each party must approve and intend for their signature to be attached to a final form document. Exchanging pre-signed signature pages is not sufficient to execute certain documents effectively.

4 Financial Assistance

4.1 Are there prohibitions or restrictions on the ability of a company to guarantee and/or give security to support borrowings incurred to finance or refinance the direct or indirect acquisition of: (a) shares of the company; (b) shares of any company which directly or indirectly owns shares in the company; or (c) shares in a sister subsidiary?

(a) Shares of the company

A private company can provide financial assistance (including guarantees and security) for the acquisition of its own shares.

Subject to limited exceptions, a public company is prohibited from giving financial assistance for the acquisition of its own shares.

(b) Shares of any company which directly or indirectly owns shares in the company

Private companies can provide financial assistance for the acquisition of shares in a private holding company but not a public holding company.

Public companies are prohibited from providing financial assistance to both public and private holding companies subject to limited exceptions.

(c) Shares in a sister subsidiary

There is no prohibition on financial assistance provided for the purchase of shares in a sister subsidiary.

5 Syndicated Lending/Agency/Trustee/Transfers

5.1 Will your jurisdiction recognise the role of an agent or trustee and allow the agent or trustee (rather than each lender acting separately) to enforce the loan documentation and collateral security and to apply the proceeds from the collateral to the claims of all the lenders?

Yes, this is usually governed by the agency provisions in the loan documentation and intercreditor or security agreement. The intercreditor agreement will govern how proceeds from security enforcement will be applied.

5.2 If an agent or trustee is not recognised in your jurisdiction, is an alternative mechanism available to achieve the effect referred to above which would allow one party to enforce claims on behalf of all the lenders so that individual lenders do not need to enforce their security separately?

Agency and trust relationships are well established in England.

5.3 Assume a loan is made to a company organised under the laws of your jurisdiction and guaranteed by a guarantor organised under the laws of your jurisdiction. If such loan is transferred by Lender A to Lender B, are there any special requirements necessary to make the loan and guarantee enforceable by Lender B?

Syndicated loans are generally structured so that they are transferrable from one lender to another by using a prescribed form of transfer certificate subject to any restrictions in the loan documentation. A transfer of the loan will also transfer the benefit of any English security or guarantee.

If a loan has not been structured in this way then (assuming no contractual prohibitions to the contrary) it is possible to assign the benefit of the loan and guarantee to Lender B by giving notice to the borrower and guarantor. Care should be taken if the loan is a revolving credit or not fully drawn, as the obligation to lend cannot be transferred by assignment (so Lender A would still be required to make further advances) and any future drawings may not benefit from the guarantee.

6 Withholding, Stamp and other Taxes; Notarial and other Costs

6.1 Are there any requirements to deduct or withhold tax from (a) interest payable on loans made to domestic or foreign lenders, or (b) the proceeds of a claim under a guarantee or the proceeds of enforcing security?

Yes, but subject to several exceptions, one or more of which generally apply in most transactions.

The starting principle is that a company paying "yearly interest" that arises in the UK is required to withhold income tax from that interest at a rate of (currently) 20%. Interest will be "yearly interest" for these purposes if, in broad terms, the debt is part of a scheme or arrangement of borrowing intended to be capable of being outstanding for a year or more.

There are several exceptions. In the context of a commercial bank loan, the most important exception is that for interest payable on an advance from a domestic "bank" or a domestic branch of a foreign "bank", where the person beneficially entitled to the interest is within the charge to UK corporation tax in respect of that interest, or would have been within the charge to UK corporation tax in respect of the interest but for the exemption from UK corporation tax for foreign branches of UK companies.

Other possible exemptions include: interest paid by a bank in the ordinary course of the bank's business; interest paid to a company within the charge to UK corporation tax; and interest payable without deduction under a direction to pay gross pursuant to a double tax treaty.

UK law is not clear on the treatment of payments made under a guarantee. They could be characterised as being of the same nature as the underlying obligation (i.e. interest or principal), or as a separate obligation. This characterisation will determine the UK withholding tax treatment of payment and which exemptions may be available.

6.2 What tax incentives or other incentives are provided preferentially to foreign lenders? What taxes apply to foreign lenders with respect to their loans, mortgages or other security documents, either for the purposes of effectiveness or registration?

There are no preferential tax incentives for foreign lenders lending into the UK.

Note that UK stamp duty could be payable on the transfer or assignment of certain loans (whether the lender is foreign or domestic). In addition, if the loan is a "chargeable security", UK stamp duty reserve tax (SDRT) could be chargeable in respect of an agreement to transfer the loan.

An exemption from UK stamp duty and SDRT applies to loans which are "exempt loan capital". A typical bank loan is likely to be "loan capital". However, if the loan has certain equity-like characteristics (e.g. convertibility, results-dependency, excessive rate of interest), it will not be "exempt". It is rare for bank loans to carry such rights, although there may be concerns where loans carry a margin ratchet or are limited recourse. Where a loan is not exempt loan capital, other exemptions from stamp duty and SDRT may be available.

The grant of security over assets should not be subject to UK stamp duties or taxes. There may be a liability to UK stamp duties or taxes on enforcement of security over shares or securities of a UK company or UK real estate.

6.3 Will any income of a foreign lender become taxable in your jurisdiction solely because of a loan to, or guarantee and/or grant of, security from a company in your jurisdiction?

By themselves, these factors should not bring a non-UK lender into the charge to UK tax (although, as discussed at question 6.1 above, a foreign lender may be subject to UK withholding tax).

6.4 Will there be any other significant costs which would be incurred by foreign lenders in the grant of such loan/guarantee/security, such as notarial fees, etc.?

See question 3.9 above.

6.5 Are there any adverse consequences for a company that is a borrower (such as under thin capitalisation principles) if some or all of the lenders are organised under the laws of a jurisdiction other than your own? Please disregard withholding tax concerns for purposes of this question.

Results-dependent interest will be characterised as a non-deductible distribution of the borrower for UK tax purposes. There is an exemption from this rule where the recipient of the interest is within the charge to UK corporation tax. Therefore, a borrower might be disadvantaged in such circumstances where a lender is outside the UK tax net. There is, however, an exemption for certain margin ratchets which does not depend on the location of the lender. In certain circumstances, UK anti-hybrid legislation may be potentially applicable to cross-border financing arrangements, very broadly, where the arrangements are subject to different tax treatments in the relevant jurisdiction which results in a tax benefit.

Otherwise, the location of an unconnected lender should not concern the borrower.

7 Judicial Enforcement

7.1 Will the courts in your jurisdiction recognise a governing law in a contract that is the law of another jurisdiction (a "foreign governing law")? Will courts in your jurisdiction enforce a contract that has a foreign governing law?

The English courts will generally apply a foreign law as the governing law of a contract if it is expressly chosen by the parties, subject to the following: (i) where all elements relevant to the situation at the time of the choice are located in a country other than the country whose law has been chosen, the choice of law will not prejudice the application of non-derogable laws of that other country; (ii) where all elements relevant to the situation at the time of the choice are located in one or more EU Member States, the choice of a non-EU Member State law will not prejudice the application of non-derogable provisions of EU community law; (iii) the chosen law will not restrict the application of overriding mandatory provisions of English law; (iv) effect may be given to overriding mandatory provisions of the law of the country where the obligations arising out of the contract have to be or have been performed, insofar as those overriding mandatory provisions render the performance of the contract unlawful; (v) the English courts may refuse to apply a provision of the chosen law if such application is manifestly incompatible with English public policy; (vi) in relation to the manner of performance and the steps to be taken in the event of defective performance, regard will be given to the law of the country in which performance takes place; and (vii) the chosen law may not be applied to determine certain questions in relation to the existence and validity of a contract.

The situation may differ for (a) consumer contracts, and (b) certain specialist situations (such as where a contract contravenes exchange controls of an IMF member state), but generally these are not of concern to lending transactions. Given that the circumstances in which the English courts might apply a different law are narrow, the basic position is that the English court will generally respect the chosen law.

7.2 Will the courts in your jurisdiction recognise and enforce a judgment given against a company in New York courts or English courts (a "foreign judgment") without re-examination of the merits of the case?

A foreign judgment would generally be treated as constituting a cause of action against the judgment debtor and could be sued upon summarily in the English courts. The English courts should enter judgment in such proceedings, without re-examination of the merits of the original judgment, provided that: (i) the New York court was of competent jurisdiction and the foreign judgment is final and conclusive; (ii) the foreign judgment is not for multiple damages or on a claim for contribution in respect of multiple damages; (iii) the foreign judgment is for a fixed sum of money and not payable in respect of a tax, fine or penalty; (iv) the foreign judgment was not given in proceedings brought in breach of a dispute resolution agreement (unless the proceedings were brought with the agreement of judgment debtor or the judgment debtor counterclaimed in the proceedings or otherwise submitted to the jurisdiction); (v) the foreign judgment was not obtained by fraud, or in proceedings contrary (a) to natural justice, (b) to the Human Rights Act 1998, (c) to the principles of the European Convention on Human Rights, (d) to the Charter of Fundamental Rights of the European Union, (e) or to English public policy; (vi) enforcement proceedings are instituted within six years after the date of the judgment; (vii) the foreign judgment is not inconsistent with an earlier judgment in proceedings between the same parties or their privies; and (viii) the foreign judgment is not contrary to the Protection of Trading Interests Act 1980 or any powers exercised under the 1980 Act.

There is doubt as to the enforceability in England and Wales of U.S. judgments in respect of civil judgments predicated purely on U.S. securities laws.

Different considerations may apply if the judgment debtor is a state or sovereign entity.

7.3 Assuming a company is in payment default under a loan agreement or a guarantee agreement and has no legal defence to payment, approximately how long would it take for a foreign lender to (a) assuming the answer to question 7.1 is yes, file a suit against the company in a court in your jurisdiction, obtain a judgment, and enforce the judgment against the assets of the company, and (b) assuming the answer to question 7.2 is yes, enforce a foreign judgment in a court in your jurisdiction against the assets of the company?

The answer is context-specific and dependent upon the court diary.

(a) If the enforcement of an English law-governed contract in England is uncontested and there is no dispute as to jurisdiction, a judgment in default could be obtained in one to two months. If the company files a defence but the foreign lender is able to obtain summary judgment, this could take two to three months. If the matter is heavily contested and there is a material dispute about the facts then it could take longer. If the governing law of the contract is not English law then the proceedings may take longer since the court will need to hear expert evidence on that foreign governing law. In terms of enforcing a judgment, once given, against assets, the time taken will depend upon which assets and what method of enforcement is chosen.

(b) For enforcement of a foreign judgment against assets, the timing would be no different.

7.4 With respect to enforcing collateral security, are there any significant restrictions which may impact the timing and value of enforcement, such as (a) a requirement for a public auction, or (b) regulatory consents?

Generally no, but regulatory consents may be required if the company is a regulated entity or the assets are regulated.

7.5 Do restrictions apply to foreign lenders in the event of (a) filing suit against a company in your jurisdiction, or (b) foreclosure on collateral security?

No, foreign lenders are essentially treated the same as domestic lenders. It may, however, be more likely that a court would make an order for security for costs against foreign lenders.

7.6 Do the bankruptcy, reorganisation or similar laws in your jurisdiction provide for any kind of moratorium on enforcement of lender claims? If so, does the moratorium apply to the enforcement of collateral security?

In liquidation, the aim is to realise the unsecured assets of the company for the benefit of creditors as a whole (save for secured creditors, who have recourse to the secured assets). Security rights against the company remain enforceable. In a compulsory liquidation, there is a limited moratorium meaning that no action or proceedings can be commenced or proceeded with against the company or its property without court permission. In the case of a creditors' voluntary liquidation, the liquidator may apply for a stay of such proceedings to ensure equal distribution of the assets.

In administration, an interim statutory moratorium on creditor action comes into effect on the presentation of an administration application in court or the filing in court of a notice of intention to appoint an administrator. This prevents, among other things, the enforcement of security and the commencement of legal proceedings without the permission of the court and a permanent moratorium will come into effect upon the appointment of an administrator (the interim moratorium falling away if the appointment is not made) which cannot be lifted without with consent of the court or the administrator.

A limited 28-day moratorium is available in a CVA but only for "small companies".

Subject to certain conditions, the enforcement of financial collateral security (which is, broadly, security over cash, shares, tradeable bonds and certain loans which meet other specified criteria) is exempt from the security enforcement moratorium.

A scheme of arrangement does not impose a moratorium on creditor action but may cram down dissenting secured creditors who will be bound by the scheme if approved by the requisite statutory majorities.

Special insolvency measures apply to credit institutions and investment firms under the Banking Act 2009, pursuant to which the resolution authorities have wide powers to impose a variety of stays.

7.7 Will the courts in your jurisdiction recognise and enforce an arbitral award given against the company without re-examination of the merits?

The award of an English seated arbitration tribunal may be enforced, with the permission of the English court, in the same manner as a judgment or order of the court to the same effect without any re-examination of the merits. This is subject to the fact that a party may be able to challenge the award if the tribunal lacked substantive jurisdiction, on grounds of a serious procedural irregularity or may be able to bring an appeal on a question of English law (the latter may be excluded by the parties in their agreement to arbitrate).

The grounds for refusing to recognise or enforce an award of a tribunal seated in a jurisdiction which has ratified the New York Convention are limited. They are: (a) that a party to the arbitration agreement was (under the law applicable to it) under some incapacity; (b) that the arbitration agreement was not valid under the law to which the parties subjected it or, failing any indication thereon, under the law of the country where the award was made; (c) that the party was not given proper notice of the appointment of the arbitrator or the arbitration proceedings or was otherwise unable to present its case; (d) that the award deals with a difference not contemplated by or not falling within the terms of the submission to arbitration or contains decisions on matters beyond the scope of the submission to arbitration; (e) that the composition of the arbitral tribunal or the arbitral procedure was not in accordance with the agreement of the parties or, failing such agreement, with the law of the country in which the arbitration took place; and (f) that the award has not yet become binding on the parties, or has been set aside or suspended by a competent authority of the country in which, or under the law of which, it was made.

8 Bankruptcy Proceedings

8.1 How does a bankruptcy proceeding in respect of a company affect the ability of a lender to enforce its rights as a secured party over the collateral security?

The government has stated its intention to introduce a new moratorium to prevent creditor enforcement action whilst a company considers its options for rescue. The government intends to legislate on this point "as soon as parliamentary time permits".

The existing statutory moratorium (which will arise in an administration and in some CVAs; see question 7.6 above) will restrict a creditor from enforcing its security rights including, for example, by appointing a receiver (see question 7.6 above).

However, if during the interim moratorium a secured creditor appoints an administrative receiver before the appointment of the administrator becomes effective, it will not be possible for an administrator to be appointed (and the interim moratorium on enforcement of security will terminate and the permanent moratorium will not come into effect). This 'trumping' of appointments only applies where the receiver appointed is an administrative receiver. Where a non-administrative receiver is appointed, an administrator can still be appointed and the administrator can require the receiver to vacate office even though the receivership enforcement process has commenced, although there are certain protections for secured creditors.

The ability to appoint an administrative receiver is only available in limited circumstances. For this reason, a secured creditor who is a 'qualifying floating charge holder' (a holder of security, including a floating charge over the whole or substantially the whole of the company's assets) may instead appoint an administrator out of court as a means of enforcing its security. Unlike a receiver, an administrator is required to act in the interests of all creditors.

8.2 Are there any preference periods, clawback rights or other preferential creditors' rights (e.g., tax debts, employees' claims) with respect to the security?

Liquidators and administrators are granted wide anti-avoidance powers to challenge certain types of transactions entered into by a company before insolvency. Clawback could be available in relation to certain transactions, such as transactions at an undervalue, preferences or wholly or partially invalid floating charges.

Certain conditions must be met for clawback to be available including:

- the company must be either in liquidation or administration;
- the company must have been unable to pay its debts when the transaction was entered into or as a result of entering into the transaction;
- an unfair advantage was gained by the party contracting with the company, or there is an absence of adequate consideration flowing to the company, as a result of the transaction; and
- the transaction was entered into during the relevant look-back period which varies (generally ranges from six months to two years).

Certain claims are treated as preferential and hence the order of priority in which a company's assets will be distributed is broadly: (i) fixed-charge holders' claims out of the fixed charge assets (if the assets are insufficient to meet these claims then the secured creditor will have a claim as an unsecured creditor for the surplus); (ii) insolvency expenses; (iii) preferential claims (primarily employee and certain pension contribution claims, and Financial Services Compensation Scheme claims (where relevant), but not currently tax claims); (iv) prescribed part fund (paid *pro rata* to unsecured claimants out of floating charge assets ahead of floating charge creditors – up to a maximum of £600,000 per company); (v) floating charge claims; (vi) unsecured claims (customers, contractors, suppliers and secured creditors whose security is insufficient); and (vii) shareholders (if there are any remaining assets).

8.3 Are there any entities that are excluded from bankruptcy proceedings and, if so, what is the applicable legislation?

The starting position is that the corporate insolvency regimes under the Insolvency Act 1986 apply to companies registered in the United Kingdom (schemes of arrangement and compulsory liquidation proceedings can also apply to companies with a "sufficient connection" to the UK).

However, by virtue of the EC Insolvency Regulation and the Recast Insolvency Regulation, insolvency proceedings can only be opened as main proceedings in the place where the debtor has its 'centre of main interests' (COMI). The Insolvency Act 1986 therefore provides that insolvency proceedings are available to a company which is incorporated in an EEA State other than the UK and a company not incorporated in an EEA State but having its COMI in a Member State (other than Denmark), subject to the overriding requirement that the COMI must be in the UK. Secondary proceedings can be opened in a Member State where the debtor has an "establishment" but these are limited to local assets in the jurisdiction.

Modified versions of the Insolvency Act regimes also apply to certain types of debtors/businesses, such as partnerships, which are dealt with by the Insolvent Partnerships Order 1994.

Special legislation and special insolvency regimes may apply to certain businesses (such as banks/credit institutions and investment firms).

8.4 Are there any processes other than court proceedings that are available to a creditor to seize the assets of a company in an enforcement?

The five main (out-of-court) remedies generally available to a creditor to enforce its security are:

1. going into possession;
2. exercising the power of sale;
3. appointment of a receiver;
4. appointment of an administrator; and
5. appropriation of financial collateral.

Foreclosure is also an enforcement process but requires a court order. Appropriation of an asset does not require a court order but can only be used to enforce financial collateral and is subject to certain conditions.

The preferred method for enforcing security is usually the appointment of a receiver or administrator (in circumstances where any receiver would be an administrative receiver and such an appointment would be prohibited).

9 Jurisdiction and Waiver of Immunity

9.1 Is a party's submission to a foreign jurisdiction legally binding and enforceable under the laws of your jurisdiction?

The English courts will usually decline jurisdiction if the parties have agreed that a foreign court is to have exclusive jurisdiction. However, the English courts may assume jurisdiction in special cases, for example: (i) if they have exclusive jurisdiction, such as in a dispute relating to rights *in rem* in land or corporate constitutional issues; (ii) in relation to certain insurance, consumer and employment contracts; (iii) if the defendant has taken steps in the proceedings in the English courts; and (iv) in certain narrow circumstances, if the court considers that it is the appropriate forum to hear the dispute. This principle is rarely applied where exclusive jurisdiction has been conferred on a foreign court. It is not applied where the chosen court is that of an EU Member State.

9.2 Is a party's waiver of sovereign immunity legally binding and enforceable under the laws of your jurisdiction?

The English courts will normally give effect to a clause in an agreement that provides for (i) the submission by a foreign state to what the courts describe as their "adjudicative jurisdiction" (i.e. the courts' power to adjudicate upon claims against foreign states, which includes recognising a foreign judgment or arbitral award), and (ii) the consent in writing of a foreign state to: (a) relief against the foreign state by way of injunction or order for specific performance or for the recovery of land or other property; and (b) the property of the foreign state being subject to any process for the enforcement of a judgment or arbitration award or, in an action *in rem*, for its arrest, detention or sale, provided, in the case of both (i) and (ii) that the agreement is sufficiently clear and the agreement is within the scope of and is permitted by the State Immunity Act 1978.

Central banks are afforded greater protection than foreign states under the 1978 Act. Different considerations apply to the immunity of international organisations, as well as to diplomatic or consular immunity.

The common law has a concept of "non-justiciability" or "act of state doctrine" which means that certain matters are not capable of being adjudicated by the English courts.

10 Licensing

10.1 What are the licensing and other eligibility requirements in your jurisdiction for lenders to a company in your jurisdiction, if any? Are these licensing and eligibility requirements different for a "foreign" lender (i.e. a lender that is not located in your jurisdiction)? In connection with any such requirements, is a distinction made under the laws of your jurisdiction between a lender that is a bank versus a lender that is a non-bank? If there are such requirements in your jurisdiction, what are the consequences for a lender that has not satisfied such requirements but has nonetheless made a loan to a company in your jurisdiction? What are the licensing and other eligibility requirements in your jurisdiction for an agent under a syndicated facility for lenders to a company in your jurisdiction?

There are generally no eligibility requirements, although certain types of lending are regulated in England (e.g. consumer credit).

11 Other Matters

11.1 Are there any other material considerations which should be taken into account by lenders when participating in financings in your jurisdiction?

Article 55 of the European Union's Bank Recovery and Resolution

Directive (2014/59/EU) requires a wide range of non-EU law governed contracts entered into by certain EU financial institutions, investment firms and their related entities to include wording by which the counterparty recognises that the in-scope entity's liabilities may be subject to bail-in by relevant EU authorities (broadly, the counterparty's claims may be written down or converted to equity).

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Finland

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1 Overview

1.1 What are the main trends/significant developments in the lending markets in your jurisdiction?

Nordic banks hold a strong position, although international banks, especially German banks as well as alternative capital providers, continue to increase their market share. Competition among lenders remains fairly intense as many Finnish blue chip companies have limited need for debt funding due to strong balance sheets and plenty of liquidity. The debt capital markets in Finland have also been developing strongly and an increasing number of, in particular, publicly traded companies, but also private companies, have raised funding through bond financing. A number of large Finnish publicly traded companies have Euro Medium Term Note programmes in place and the Finnish corporate bond market, where bonds are issued under local law documentation, has developed favourably. In terms of industries, real estate financing has also grown increasingly over the past few years thanks to several significant real estate transactions in Finland. The year 2018 was characterised by several large public tender offers where Finnish listed companies were acquired by foreign bidders and the related finance transactions.

2 Guarantees

2.1 Can a company guarantee borrowings of one or more other members of its corporate group (see below for questions relating to fraudulent transfer/financial assistance)?

Finnish limited liability companies are generally free to guarantee the financial obligations of one or more members of their corporate group, subject, however, to certain limitations described under questions 2.2 and 4.1 below.

2.2 Are there enforceability or other concerns (such as director liability) if only a disproportionately small (or no) benefit to the guaranteeing/securing company can be shown?

Potential concerns of, in particular, unlawful financial assistance and distribution of assets may arise especially in relation to upstream as well as cross-stream guarantees and security (on financial assistance, please see section 4 below). If the provision of a guarantee or security reduces the assets of a company or increases its liabilities without such company obtaining sufficient corporate benefit therefrom, such actions may constitute unlawful distribution of assets under the Companies Act (624/2006, as amended, the "**Companies Act**"). In addition to such corporate benefit requirement, provision of the guarantee/security: (i) must fall within the company's business purpose; (ii) may not contravene the provisions of the Companies Act regarding the equality of shareholders; and (iii) may not result in the company becoming insolvent, nor may the company be insolvent at the time of granting the guarantee/security.

Failure to comply with the above requirements may constitute a breach of the general duty of care imposed on the Board of Directors and the managing director of a Finnish limited liability company pursuant to the Companies Act and result in liability to pay damages to the company, its shareholders or third parties or even criminal sanctions if such distribution constitutes deliberate violation of the protection of the company's shareholders or creditors.

In order to alleviate the above concerns, finance documents typically include wording limiting any guarantees and security provided by Finnish companies to the extent that the provision of such guarantees or security would be contrary to the mandatory provisions of the Companies Act regarding financial assistance and/or unlawful distribution of assets or, in the case of companies that do not apply the Companies Act (*e.g.* housing companies that apply the Housing Companies Act (1599/2009, as amended)), other mandatory provisions of Finnish corporate law. Kindly note that, in this chapter, we focus only on Finnish limited liability companies applying the Companies Act unless otherwise specifically noted.

2.3 Is lack of corporate power an issue?

Lack of corporate power is generally not an issue *per se,* with the provision of guarantees and security usually being resolved upon by the Board of Directors or, if such action falls within the ordinary course of business, even the managing director. The general duty of care requirements and risk of unlawful financial assistance and distribution of assets described under question 2.2 above and section 4 below may, however, impose *de facto* limitations on the provision of guarantees and/or security.

2.4 Are any governmental or other consents or filings, or other formalities (such as shareholder approval), required?

No governmental or other consent or filing is required in order for a Finnish limited liability company to provide guarantees. Please, however, see question 3.9 below regarding registration requirements in respect of certain security assets. Although not a requirement in all cases (unless so provided for by, *e.g.*, an applicable internal policy or articles of association), shareholder approval is often requested as a condition precedent in financing arrangements.

2.5 Are net worth, solvency or similar limitations imposed on the amount of a guarantee?

Although there are no limitations on the amount of a guarantee *per se*, the provisions of the Companies Act may in practice limit the amount of a guarantee that can be considered valid and enforceable. In particular, Finnish limited liability companies may not provide guarantees if doing so would violate the provisions of the Companies Act relating to unlawful financial assistance or distribution of assets, or endanger the guarantor's solvency. Please see question 2.2 above and questions 4.1 and 8.2 below.

2.6 Are there any exchange control or similar obstacles to enforcement of a guarantee?

There are no exchange control or similar obstacles in Finland restricting the enforcement of guarantees issued by Finnish limited liability companies.

3 Collateral Security

3.1 What types of collateral are available to secure lending obligations?

Under Finnish law, various types of security assets (including but not limited to shares, real estate, business mortgages and receivables) may be pledged as security. In order to validly pledge an asset, such asset must be: (i) sufficiently individualised; (ii) separately transferable and capable of being foreclosed on; and (iii) have monetary value.

3.2 Is it possible to give asset security by means of a general security agreement or is an agreement required in relation to each type of asset? Briefly, what is the procedure?

Under Finnish law, it is possible and common market practice to grant security over various assets by way of a single omnibus security agreement.

3.3 Can collateral security be taken over real property (land), plant, machinery and equipment? Briefly, what is the procedure?

Under Finnish law, security over real property is taken by registering a real estate mortgage on the relevant real estate (or *e.g.* a part or parcel thereof or leasehold registered thereon) and perfected by: (i) in the case of electronic real estate mortgage(s), registering the pledgee as the recipient thereof (such application can be made by the then registered recipient of the mortgage); or (ii) in case of existing physical real estate mortgage note(s), by delivering the real estate mortgage note(s) representing such real estate mortgage to the possession of the pledgee or its order. It is no longer possible to apply for the registration of a new real estate mortgage evidenced by a physical mortgage note, although currently existing physical mortgage notes can be used as security until the end of 2019, after which time they will need to be converted into electronic format (for use as security for new loans). Various Finnish banks have already converted physical mortgage notes held by them as security into electronic format.

Security over machinery and equipment can be taken in a number of ways. For one, machinery and equipment may be pledged as movable property subject to a fixed charge, such pledge to be perfected by delivering such machinery and equipment to the possession of the pledgee or its order or by otherwise precluding the pledgor from utilising such assets or, in the event that such assets are in the possession of a third party, by delivering a notice of pledge to such third party. Secondly, a business mortgage registered against a Finnish company will, in principle, cover all of its movable business assets (including plant, machinery and equipment), without limiting the pledgor's ability to dispose of such assets in the ordinary course of its business. A business mortgage must be registered with the Finnish Patent and Registration Office and such security is perfected by delivering the relevant business mortgage note(s) to the possession of the pledgee or its order.

Under certain circumstances, machinery and equipment may, however, be considered sufficiently integrated with the underlying real estate or leasehold to constitute fixtures or appurtenances thereof, thus falling within the scope of a real estate mortgage rather than a business mortgage. It should also be noted that, under Finnish law, it is possible to register such assets as belonging or, conversely, not belonging, to the underlying real estate or leasehold.

In addition to business mortgages and real estate mortgages, there are also certain limited movable assets (being aircraft, certain vessels and certain vehicles), over which security can be taken by registering a mortgage.

3.4 Can collateral security be taken over receivables? Briefly, what is the procedure? Are debtors required to be notified of the security?

Under Finnish law, security can be taken over receivables and is perfected by delivering a notice to the relevant debtor, with instructions to make all payments to the pledgee or its order. In practice, perfection is usually delayed and the debtor continues to make payments to the pledgor until the occurrence of a credit event, even though the security is thus subject to a risk of clawback. It should, however, be noted that Finnish law does not contain provisions regarding the pledge of future receivables which do not derive from pledged assets. The prevailing view of legal scholars is that receivables that exist before the pledgor-debtor is declared bankrupt or enforcement proceedings commence should be regarded as being subject to a perfected security interest *vis-à-vis* third parties, although it is recommended that another separate notice is served on the relevant debtor(s) each time after such receivables have been earned.

3.5 Can collateral security be taken over cash deposited in bank accounts? Briefly, what is the procedure?

Under Finnish law, security can be taken over cash deposited in bank accounts and is perfected by delivering a notice of pledge to the account bank with instructions to prohibit the pledgor from making withdrawals from or otherwise using the account. To the extent that, *e.g.*, deposit accounts are pledged, the parties generally agree on delayed perfection, where the pledgor is only precluded from stipulating over the account(s) following certain credit events. It should, however, be noted that until the security is fully perfected, the pledge will not be considered effective in relation to the pledgor's third-party creditors.

3.6 Can collateral security be taken over shares in companies incorporated in your jurisdiction? Are the shares in certificated form? Can such security validly be granted under a New York or English law-governed document? Briefly, what is the procedure?

Share pledges are commonly used as security in Finland. Security taken over shares in a company is perfected: (i) if no share certificates have been issued, by notifying such company of the pledge and, customarily, requesting that it record such pledge in its shareholder register; or (ii) if share certificates have been issued, by delivering the share certificates to the possession of the pledgee, usually endorsed in blank (although not a requirement, notice as referred to under (i) above is often delivered to the relevant company and a note of the pledge added to its shareholder register even if it has issued share certificates). Dematerialised shares registered on a book-entry account may also be pledged, with such security being perfected by notice to the relevant book-entry register and registration of the pledge therein.

Choice of foreign law (such as English or New York law) is generally accepted (please also see sections 7 and 9 below) and valid *inter partes* unless the application of such foreign law would be contrary to the fundamental principles of Finnish law. It should, however, be noted that the parties cannot by choice of law circumvent mandatory provisions of Finnish law regarding, *e.g.*, protection of third-party creditors. Prevalent market practice is thus for share pledge agreements creating security over shares in Finnish entities to be governed by Finnish law.

3.7 Can security be taken over inventory? Briefly, what is the procedure?

In order to validly perfect a pledge over inventory, the pledgor must be precluded from stipulating over the pledged assets. This may be effected by transferring physical possession of the asset(s) to the pledgee or its order, or allowing the asset to remain in the pledgor's premises but preventing the pledgor from accessing and dealing with the asset(s) (such as disposing thereof) through factual arrangements (*e.g.* handing over the keys to such premises to a third party). Although inventory pledges may in many cases be considered impractical, oil reserves have been used as security in a novel manner in Finland where an independent third party was engaged to operate, manage and control the pledged oil reserves on behalf of the pledgee and the pledgor was entitled to request the release of a certain portion thereof from time to time. Nevertheless, a more common way to take security over movable assets such as inventory would be by way of a business mortgage as described under question 3.3 above.

3.8 Can a company grant a security interest in order to secure its obligations (i) as a borrower under a credit facility, and (ii) as a guarantor of the obligations of other borrowers and/or guarantors of obligations under a credit facility (see below for questions relating to the giving of guarantees and financial assistance)?

In general, yes. Please, however, see question 2.2 above and section 4 below regarding certain limitations to the provision of guarantees and security and question 8.2 below in relation to recovery issues.

3.9 What are the notarisation, registration, stamp duty and other fees (whether related to property value or otherwise) in relation to security over different types of assets?

Under Finnish law, no notarisation, registration, stamp duty or other fees are payable in connection with granting security over receivables, shares or other movable assets which are not registered, save for customary court and enforcement authority fees. The creation of security over publicly registered assets (*e.g.* real property and business mortgages) is generally subject to minor registration fees.

3.10 Do the filing, notification or registration requirements in relation to security over different types of assets involve a significant amount of time or expense?

Notification and registration procedures, as referred to under questions 3.3–3.7 above, are usually initiated promptly and completed within a couple of weeks, and do not generate significant expense. In respect of assets where multiple counterparties need to be notified in order to perfect the security (*e.g.* in respect of rental income), perfection may, however, generate material costs or undue administrative burden, which is why such security is often subject to delayed perfection. Under Finnish law, there are no filing requirements in relation to the creation of security, except that in connection with legal proceedings, the relevant security agreements may need to be filed with the appropriate court or administrative body and translated into Finnish or Swedish.

3.11 Are any regulatory or similar consents required with respect to the creation of security?

No regulatory or similar consent is required in order to create a valid security interest in Finland.

3.12 If the borrowings to be secured are under a revolving credit facility, are there any special priority or other concerns?

Securing obligations under a revolving credit facility does not raise any particular priority or other concerns under Finnish law (assuming that additional security is not granted in connection with subsequent drawdowns, which could raise clawback concerns). Please also see question 8.2 below in respect of recovery issues.

3.13 Are there particular documentary or execution requirements (notarisation, execution under power of attorney, counterparts, deeds)?

Although Finnish law does not impose any particular documentary or execution requirements in relation to the creation of security interests or the provision of guarantees, it is recommended that all security agreements and guarantees are made in writing.

4 Financial Assistance

4.1 Are there prohibitions or restrictions on the ability of a company to guarantee and/or give security to support borrowings incurred to finance or refinance the direct or indirect acquisition of: (a) shares of the company; (b) shares of any company which directly or indirectly owns shares in the company; or (c) shares in a sister subsidiary?

(a) Shares of the company

Pursuant to the Companies Act, a Finnish limited liability company cannot provide a loan, funds, security or a guarantee for the purpose of enabling a third party to acquire shares in such company or its Finnish parent company.

(b) Shares of any company which directly or indirectly owns shares in the company

Under the Companies Act, the prohibition of financial assistance described under paragraph (a) above applies to Finnish parent companies of Finnish limited liability companies. The Companies Act and the Accounting Act (1336/1997, as amended) define a parent company in relation to its subsidiary as an entity which: (i) holds over 50 per cent of such subsidiary's shares or voting rights; (ii) has the ability to appoint a majority of such subsidiary's board of directors or similar; or (iii) otherwise holds *de facto* control over such subsidiary. Therefore, the financial assistance provisions under the Companies Act do not apply to the extent a shareholder is not considered a Finnish parent company. Notwithstanding the foregoing, the provisions concerning corporate benefit, unlawful distribution of assets and equal treatment of shareholders referred to under question 2.2 above should be taken into account.

(c) Shares in a sister subsidiary

The provision of guarantees and/or security for the purpose of enabling the acquisition of the shares in a sister company is not subject to the financial assistance prohibition described under paragraph (a) above. However, the provisions concerning corporate benefit, unlawful distribution of assets and equal treatment of shareholders referred to under question 2.2 above should be taken into account.

5 Syndicated Lending/Agency/Trustee/Transfers

5.1 Will your jurisdiction recognise the role of an agent or trustee and allow the agent or trustee (rather than each lender acting separately) to enforce the loan documentation and collateral security and to apply the proceeds from the collateral to the claims of all the lenders?

Although the concept of a trustee is not recognised under Finnish law, lenders may appoint a facility and/or security agent to represent them in all matters relating to the finance documents and/or security. Agents may be appointed to enforce, for and on behalf of the lenders, any of their rights under the finance documents, including any security, and to apply the proceeds therefrom in satisfaction of the secured claims of the lenders, in each case subject to and as set out in the relevant finance documentation. However, pursuant to recent discussions with the relevant authorities, it seems unlikely that a bankruptcy administrator would depart from Finnish law regarding the priority of claims on the basis of an intercreditor agreement or any other document contractually subordinating claims among each other. Accordingly, particular emphasis should be placed on turnover provisions in such documentation.

5.2 If an agent or trustee is not recognised in your jurisdiction, is an alternative mechanism available to achieve the effect referred to above which would allow one party to enforce claims on behalf of all the lenders so that individual lenders do not need to enforce their security separately?

Please see question 5.1 above.

5.3 Assume a loan is made to a company organised under the laws of your jurisdiction and guaranteed by a guarantor organised under the laws of your jurisdiction. If such loan is transferred by Lender A to Lender B, are there any special requirements necessary to make the loan and guarantee enforceable by Lender B?

In order to perfect the transfer of a loan and ensure its enforceability against third parties, the borrower must be notified thereof and, although not a requirement, it is also prudent to notify the guarantor of such transfer in order to ensure that it does not fulfil its guarantee obligations to the original lender.

6 Withholding, Stamp and Other Taxes; Notarial and Other Costs

6.1 Are there any requirements to deduct or withhold tax from (a) interest payable on loans made to domestic or foreign lenders, or (b) the proceeds of a claim under a guarantee or the proceeds of enforcing security?

In principle, no withholding tax is deductible under Finnish law from interest payable on loans, proceeds of claims under guarantees or enforcement proceeds.

6.2 What tax incentives or other incentives are provided preferentially to foreign lenders? What taxes apply to foreign lenders with respect to their loans, mortgages or other security documents, either for the purposes of effectiveness or registration?

Please see question 6.3 below. No specific tax incentives are provided to foreign lenders in Finland.

6.3 Will any income of a foreign lender become taxable in your jurisdiction solely because of a loan to, or guarantee and/or grant of, security from a company in your jurisdiction?

No taxes apply to foreign lenders as long as they do not have a permanent establishment in Finland which is effectively connected to the proceeds of the loan, guarantee or security interest.

6.4 Will there be any other significant costs which would be incurred by foreign lenders in the grant of such loan/guarantee/security, such as notarial fees, etc.?

No. Please see question 3.9 above.

6.5 Are there any adverse consequences for a company that is a borrower (such as under thin capitalisation principles) if some or all of the lenders are organised under the laws of a jurisdiction other than your own? Please disregard withholding tax concerns for purposes of this question.

There are no adverse consequences for a Finnish borrower solely due to some or all of the lenders being established in a jurisdiction other than Finland. Finnish law does not contain any thin capitalisation rules *per se,* although there are certain restrictions on the deductibility of interest on loans owed to both related parties as well as unrelated, external parties (for the purposes of the limitations, interest is deemed to include all ancillary costs and expenses relating to a loan, including guarantee and security fees and arrangement fees). There are limited exceptions to the application of the restrictions – *e.g.* they are not applicable to financial institutions. In principle, net interest expenses are deductible up to EUR 500,000 – to the extent that net interest expenses exceed such threshold, they will be deductible up to 25 per cent of relevant company's adjusted taxable profit/loss. In general, net interest expenses to unrelated, external parties may additionally be deducted up to the amount of EUR 3,000,000 (in addition to certain other limited exemptions). Interest expenses payable on external loans are, however, treated as interest expenses payable on related party loans (and thus not entitled to the EUR 3,000,000 safe haven) if such loan is, *e.g.*, secured by a receivable owing to a related party.

7 Judicial Enforcement

7.1 Will the courts in your jurisdiction recognise a governing law in a contract that is the law of another jurisdiction (a "foreign governing law")? Will courts in your jurisdiction enforce a contract that has a foreign governing law?

The parties to a contract are generally free to choose the governing law provided that such choice is made expressly or otherwise clearly demonstrated by the contract. Finnish courts would uphold choice of foreign law, except to the extent that such would be contrary to the mandatory laws or public policy of Finland. Notwithstanding any choice of foreign law, Finnish law will be applied in any bankruptcy, insolvency, liquidation, reorganisation or other similar proceeding in respect of, or any execution proceeding against, a Finnish entity. Further, in the event that a Finnish court is unable to obtain an account of the content of applicable foreign law, Finnish law may be applied.

7.2 Will the courts in your jurisdiction recognise and enforce a judgment given against a company in New York courts or English courts (a "foreign judgment") without re-examination of the merits of the case?

Foreign judgments are in principle not recognised or directly enforceable in Finland unless otherwise provided under an international agreement or applicable law. For example, Finland and the United States have not entered into such an agreement and, thus, Finnish courts would not recognise or directly enforce a judgment rendered by a court of the State of New York.

Judgments rendered by the courts of Member States of the European Union on or after 10 January 2015 are, however, as a general rule directly enforceable in Finland in accordance with Regulation (EU) No. 1215/2012 of 12 December 2012 of the European Parliament and of the Council on Jurisdiction and the Recognition and Enforcement of Judgments in Civil and Commercial Matters (the "**Brussels I Recast**"). At the time of writing this chapter it is, however, unclear under what regime and to what extent judgments rendered by English courts will be directly enforceable in Finland following the expected departure of the United Kingdom from the European Union.

7.3 Assuming a company is in payment default under a loan agreement or a guarantee agreement and has no legal defence to payment, approximately how long would it take for a foreign lender to (a) assuming the answer to question 7.1 is yes, file a suit against the company in a court in your jurisdiction, obtain a judgment, and enforce the judgment against the assets of the company, and (b) assuming the answer to question 7.2 is yes, enforce a foreign judgment in a court in your jurisdiction against the assets of the company?

According to the Finnish Ministry of Justice, in 2017 district courts resolved civil cases within approximately 14 months and summary civil cases within approximately three months. Most civil cases are resolved through written proceedings where the processing time is shorter and only very few proceed to a main hearing. The statistics do not take into account any potential enforcement proceedings. Both Finnish and foreign judgments fulfilling the requirements of the Brussels I Recast are directly enforceable in Finland in accordance with the Enforcement Code (705/2007, as amended, the "**Enforcement Code**") upon submission of an application to the competent enforcement authority. The length of the enforcement proceedings may, however, vary significantly depending on the assets subject to enforcement.

7.4 With respect to enforcing collateral security, are there any significant restrictions which may impact the timing and value of enforcement, such as (a) a requirement for a public auction, or (b) regulatory consents?

Subject to limited exceptions, the parties to a security agreement may agree on applicable enforcement procedures. Security over most movable assets may be enforced by the creditor itself through private sale or, alternatively, the creditor may seek enforcement by bailiff in accordance with the Enforcement Code. As an exception to the foregoing, security created by way of a mortgage registered in a public register (*e.g.* business mortgages and real estate mortgages) requires an enforceable enforcement order for execution and, accordingly, such security may only be enforced by bailiff in accordance with the Enforcement Code. Security taken by way of title transfer in accordance with the Finnish Financial Collateral Act (11/2004, as amended, the "**Financial Collateral Act**") does not require enforcement through public or private sale; instead, the purchaser-pledgee may directly take ownership over the relevant securities or receivables and off-set their value against the debt due if the parties have agreed on such procedure.

7.5 Do restrictions apply to foreign lenders in the event of (a) filing suit against a company in your jurisdiction, or (b) foreclosure on collateral security?

No such restrictions apply to foreign lenders in the event of filing suit against a company in Finland or foreclosure on security, which would not apply to local lenders.

7.6 Do the bankruptcy, reorganisation or similar laws in your jurisdiction provide for any kind of moratorium on enforcement of lender claims? If so, does the moratorium apply to the enforcement of collateral security?

In principle, reorganisation proceedings under the Corporate Reorganization Act (47/1993, as amended, the "**Reorganization Act**") impose a moratorium on legal proceedings and enforcement actions against a debtor and, save for limited exceptions, no creditor may enforce security or collect debt until the court has confirmed the reorganisation plan. Notwithstanding such stay, secured creditors remain entitled to receive interest payments and other debt-related fees provided for in the original credit documentation and, under certain circumstances, with permission of the court, may even be entitled to enforce security. The commencement of bankruptcy proceedings does not, however, impose a similar moratorium – please see question 8.1 below.

Notwithstanding the foregoing, if security is granted in accordance with the Financial Collateral Act, insolvency proceedings do not affect the right of the pledgee to enforce the security or take ownership over the security assets in the manner agreed between the parties. The Financial Collateral Act is, however, only applicable to the granting of security over certain assets (being securities, cash collateral and certain receivables) provided further that the pledgor qualifies as an "institution" (*e.g.* a financial institution) under such act or the pledgee is such an institution (unless the asset used as security is a share or other security requiring the issuance of shares which are not publicly traded, in which case the act only applies if the pledgor is an institution).

7.7 Will the courts in your jurisdiction recognise and enforce an arbitral award given against the company without re-examination of the merits?

According to the New York Convention on the Recognition and Enforcement of Foreign Arbitral Awards of 1958 and subject to the Finnish Arbitration Act (967/1992, as amended), valid foreign arbitral awards will, unless contrary to the public policy/judicial system of Finland, be recognised and enforced by the courts of Finland subject to application for enforcement thereof with the District Court.

8 Bankruptcy Proceedings

8.1 How does a bankruptcy proceeding in respect of a company affect the ability of a lender to enforce its rights as a secured party over the collateral security?

In principle, the commencement of bankruptcy proceedings does not limit the right of creditors secured by a fixed charge over movable or immovable property to enforce their rights over security. A creditor seeking to enforce security must, however, provide the bankruptcy administrator with certain information on the claim and the security in a letter of lodgement as well as notice of its intention to enforce the security, including the time and place thereof. The administrator may within two weeks of receipt of such notice prohibit such enforcement for no longer than two months for the purposes of clarifying the creditor's right to the security or safeguarding the rights of the bankruptcy estate. Such restrictions do not, however, apply to creditors secured by publicly traded securities or other security granted in accordance with the Financial Collateral Act. Under certain circumstances, the bankruptcy estate may also seek the court's permission to sell the security assets or enforce the security through bailiff.

The foregoing does not, however, apply to creditors secured by a business mortgage, which may only be enforced as part of the general bankruptcy enforcement. Therefore, creditors secured by a business mortgage are entitled to proceeds from the bankruptcy estate only at the same time and through the same process as unsecured creditors, although with better priority. It should also be noted that security over business mortgages requires an enforceable enforcement order for execution (please see question 7.4 above) and that, in bankruptcy, receivables secured by a business mortgage are considered secured only up to 50 per cent of the value of the mortgaged property and rank after receivables secured by fixed charges. Please also see question 7.6 above.

8.2 Are there any preference periods, clawback rights or other preferential creditors' rights (e.g., tax debts, employees' claims) with respect to the security?

Under the Act on Recovery to a Bankruptcy Estate (758/1991, as amended) (the "**Recovery Act**"), a security interest may be recovered or reversed in connection with reorganisation, bankruptcy or enforcement proceedings as follows:

(a) security interests granted by a debtor for its own debt (including as guarantor), if such security was granted less than three months, or less than two years if granted to an affiliated party, prior to the filing for reorganisation, bankruptcy or execution and:
   - (i) was not originally agreed upon when the underlying debt was incurred; or
   - (ii) subsequently perfected without undue delay after the incurrence of the underlying debt,

   provided, however, that security granted to an affiliated party over three months but less than two years prior to the filing may be recovered or reversed unless it can be shown that the debtor was not insolvent at the time of granting the security and did not become insolvent due to the security arrangement; or

(b) if the granting of such security interest in an inappropriate manner:
   - (i) favoured a particular creditor;
   - (ii) involved the transfer of assets beyond the reach of the debtor's other creditors; or
   - (iii) increased the debtor's indebtedness to the other creditors' detriment,

   provided, however, that the debtor was either insolvent at the time or the act contributed to the debtor becoming insolvent, and the other party to the transaction was, or should have been, aware of this and of the adverse effect on the debtor's financial situation as well as of the factors that resulted in such security being considered inappropriate. Security granted more than five years prior to the filing for reorganisation, bankruptcy or execution may, however, only be recovered or reversed if granted to an affiliated party.

Further, under the Recovery Act, third-party security (i.e. where the relevant pledgor is not, *e.g.*, a borrower or guarantor) granted within one year before the filing for reorganisation, bankruptcy or execution, or, in the event that such security has been granted to an affiliated party, within three years before such filing (unless, in the case of security granted to an affiliated party, it can be shown that the pledgor-debtor was not insolvent and did not become insolvent as a result of granting the security) may be recovered, provided that the granting of such security can be considered a gift or a gratuitous agreement (although, according to certain Finnish legal scholars, if the granting of security has been a condition for the granting of the underlying loan or the security has been granted by a parent company on behalf of its subsidiary, such security should not, in normal circumstances, be subject to recovery).

8.3 Are there any entities that are excluded from bankruptcy proceedings and, if so, what is the applicable legislation?

Subject to certain exceptions (*e.g.* the State of Finland, Finnish municipalities, the Evangelical Lutheran Church and the Orthodox

Church and their parishes), any natural person or legal entity may be subject to bankruptcy proceedings under the Bankruptcy Act (120/2004, as amended). After the commencement of reorganisation proceedings under the Reorganization Act, a debtor may, however, only be declared bankrupt in limited situations.

8.4 Are there any processes other than court proceedings that are available to a creditor to seize the assets of a company in an enforcement?

In general, a pledgee may enforce security over movable property (save for business mortgages and certain other movable assets in respect of which a mortgage is registered) through private sale. Further, if security is taken by way of title transfer in accordance with the Financial Collateral Act (applicable only to limited assets and financing arrangements as discussed above), the purchaser-pledgee may take direct ownership over the relevant assets rather than enforcing the security interest over them through private or public sale if the parties have agreed on such procedure. Otherwise, enforcement (in respect of, *e.g.*, real estate mortgages) is carried out by bailiff in accordance with the Enforcement Code, and requires an enforceable judgment or arbitral award against the debtor. However, if there is a danger that the debtor may seek to hide, destroy or dispose of its assets or take any other action which would, *e.g.*, endanger repayment of indebtedness, injunctive relief can also be sought to safeguard the assets.

9 Jurisdiction and Waiver of Immunity

9.1 Is a party's submission to a foreign jurisdiction legally binding and enforceable under the laws of your jurisdiction?

Under Finnish law, the parties may agree on the submission of disputes to the courts of a foreign jurisdiction subject to certain criteria. The agreement must generally be made in writing. In addition, there are certain provisions in order to protect weaker parties, such as consumers or employees, and to ensure their access to Finnish courts at all times, which cannot be deviated from by submission to a foreign jurisdiction.

9.2 Is a party's waiver of sovereign immunity legally binding and enforceable under the laws of your jurisdiction?

Finnish legislation does not contain specific provisions on the waiver of sovereign immunity, nor has Finland ratified the European Convention on State Immunity. Further, although Finland has signed and accepted the United Nations Convention on Jurisdictional Immunities of States and Their Property, it has not entered into force yet. The Supreme Court of Finland (KKO 2007:49) has, however, suggested that an entity may validly waive its sovereign immunity. It should, nevertheless, be noted that due to limited case law and the lack of specific legislation on the matter, to what extent waiver of sovereign immunity may be considered legally binding and enforceable under Finnish law may be subject to legal interpretation.

10 Licensing

10.1 What are the licensing and other eligibility requirements in your jurisdiction for lenders to a company in your jurisdiction, if any? Are these licensing and eligibility requirements different for a "foreign" lender (i.e. a lender that is not located in your jurisdiction)? In connection with any such requirements, is a distinction made under the laws of your jurisdiction between a lender that is a bank *versus* a lender that is a non-bank? If there are such requirements in your jurisdiction, what are the consequences for a lender that has not satisfied such requirements but has nonetheless made a loan to a company in your jurisdiction? What are the licensing and other eligibility requirements in your jurisdiction for an agent under a syndicated facility for lenders to a company in your jurisdiction?

Under Finnish law, pure corporate lending (whether by domestic or foreign lenders) has generally been considered exempt from licence and other authorisation requirements, whereas operating as a credit institution (including receiving repayable funds from the public and offering credit and financing for such credit institution's own account) is subject to a licensing and/or notification requirement under the Act on Credit Institutions (610/2014, as amended). Specific requirements concerning, *e.g.*, the owners, management and financial standing of such entity further depend on whether its registered office is located in an EEA Member State. Failure to comply with such requirements may lead to administrative and criminal sanctions as well as liability for damages.

Previous guidance of the Finnish Financial Supervisory Authority (the "**FFSA**") has indicated that a foreign credit institution would not generally be subject to a licensing and/or notification requirement under Finnish law solely by reason of providing a loan to a Finnish company on an *ad hoc* basis, assuming that it does not actively solicit clients in Finland. Recent discussions with the FFSA suggest, however, that foreign credit institutions engaging in such corporate lending in Finland may, under certain circumstances, also be subject to licensing and/or notification requirements, particularly if such loans are generally made available to clients. The FFSA has not, however, provided further guidance regarding the criteria to be taken into account when making such determination and, accordingly, the situation remains largely unclear and subject to a case-by-case analysis.

There are no particular licensing or eligibility requirements for facility agents under Finnish law.

11 Other Matters

11.1 Are there any other material considerations which should be taken into account by lenders when participating in financings in your jurisdiction?

The material legal issues to be considered when participating in financing and taking security in Finland have been addressed herein.

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France

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1 Overview

1.1 What are the main trends/significant developments in the lending markets in your jurisdiction?

2018 was another very active year for lenders, with ever more pressure on loan terms and pricing. However, there were signs of stressed loans at the end of 2018 as well as pushback from lenders with respect to certain borrower-friendly loan documentation terms. Whether this trend will continue in 2019 remains to be seen.

1.2 What are some significant lending transactions that have taken place in your jurisdiction in recent years?

The French financing market saw numerous small-cap, mid-cap and large-cap LBO financing transactions in recent years. There have been several significant large-cap LBO financing transactions such as the financing of the acquisition of DRT by Ardian and the financing of the second buy-out of Domus Vi by PAI Partners.

2 Guarantees

2.1 Can a company guarantee borrowings of one or more other members of its corporate group (see below for questions relating to fraudulent transfer/financial assistance)?

Yes, subject to certain conditions, restrictions and limitations relating in particular to the French law requirement of corporate benefit and the prohibition of financial assistance – see questions 2.2, 2.3, 2.4, 2.5 and section 4 below for details.

2.2 Are there enforceability or other concerns (such as director liability) if only a disproportionately small (or no) benefit to the guaranteeing/securing company can be shown?

All guarantees and security interests granted by a French company must be in that company's corporate benefit. If only a disproportionately small (or no) benefit to the guaranteeing/securing company can be shown, the guarantee/security may be deemed as not being in the corporate benefit of the guaranteeing/securing company and may trigger the criminal liability of the managers/directors of the company (for misuse of corporate assets). Some French courts have also declared void guarantees/security interests which were not in the corporate benefit of the guaranteeing/securing company on the ground that such guarantees/security interests had been granted for an illicit cause. Although the concept of "illicit cause" no longer exists under French law since a reform of the French civil code which came into force on 1 October 2016, an equivalent concept of "illicit content of an agreement" has been introduced by the reform and may be applied by the French courts with respect to the guarantees/security interests granted after 1 October 2016 which would not comply with the corporate benefit requirements.

In case of a group of companies, French courts assess such corporate interest at the group level, but some strict criteria must be met, among which: (i) the guarantee/security interest must be granted in the common interest of the group within the framework of a common policy defined for the group as a whole; (ii) there must be some consideration for the guarantee/security interest; and (iii) the guarantee/security interest must not exceed the financial capabilities of the grantor.

A guarantee/security interest granted in order to guarantee the obligations of a subsidiary is usually unlimited as it is generally admitted that a holding company has a corporate interest in guaranteeing its subsidiary's obligations. As for upstream and cross-stream guarantees/security interests, the most commonly accepted corporate benefit justification is the granting of an intercompany loan by the guaranteed company to the guarantor out of loan proceeds made available to the guaranteed company (the guaranteed amount under the guarantee/security interest being in such case limited to the amount of such intercompany loan).

2.3 Is lack of corporate power an issue?

Guarantees granted by the legal representatives of a company are deemed to be validly granted and enforceable (as long as the granting of such guarantees does not fall outside the corporate object of the company, save for the case where (i) it has been authorised by a unanimous shareholders' resolution, or (ii) it was granted by a joint stock company (i.e., a *société anonyme,* a *société par actions simplifiée* or a *société européenne*) or by a limited liability company (i.e., a *société à responsabilité limitée*)). This rule does not, however, cover (i) guarantees which are prohibited by law, or (ii) guarantees which are subject to prior authorisation by the board of directors or by the shareholders (see question 2.4 below).

If a guarantee agreement is signed by a person who is not the legal representative of the company (and if such person does not act under a power of attorney granted by a legal representative of the company) such guarantee may be voided, save for cases where the company has confirmed the guarantee either explicitly or implicitly by performing its obligations thereunder.

2.4 Are any governmental or other consents or filings, or other formalities (such as shareholder approval), required?

No governmental consents or filings are required. Shareholder approval is not required by law (save for the case of a *société civile* offering securities to the public), but the by-laws of a company may contain clauses pursuant to which shareholder approval is required with respect to the granting of guarantees. Also, guarantees granted by a *société anonyme* are subject to authorisation by the board of directors.

If the guarantee is granted by an individual, the signature of such person must be preceded by a specific handwritten statement specifying the maximum guaranteed amount and the duration of the guarantee. A similar requirement is provided by French law with respect to guarantees granted by non-commercial companies.

2.5 Are net worth, solvency or similar limitations imposed on the amount of a guarantee?

See the answer to question 2.2 above with respect to upstream and cross-stream guarantees granted in the context of a group of companies.

Guarantees granted by a French company which is insolvent (*en état de cessation des paiements*) may be declared null and void by a French court – see question 8.2 below for more details.

A guarantee granted by an individual must be proportionate to its income and assets (otherwise, a court may declare that such guarantee is not enforceable).

2.6 Are there any exchange control or similar obstacles to enforcement of a guarantee?

There are no exchange control or similar obstacles to enforcement of a guarantee.

3 Collateral Security

3.1 What types of collateral are available to secure lending obligations?

Collateral security can be taken over tangible or intangible assets, among which are: real property; shares; financial securities; bank accounts; receivables; intellectual property rights; business as a going concern; equipment and machinery; inventory; cash; and various tangible assets. Security interests may be granted in the form of a pledge, a mortgage (real property), a lien (real property), a transfer by way of security (receivables, cash), a delegation (receivables) or a security trust (*fiducie*).

3.2 Is it possible to give asset security by means of a general security agreement or is an agreement required in relation to each type of asset? Briefly, what is the procedure?

A separate agreement must be entered into in relation to each type of asset. There are, however, some types of security interest agreements which encompass several types of assets: (i) a pledge over business as a going concern, which includes security over assets such as the company's logo and commercial name, goodwill (customer relationship) and lease rights and may also include intellectual property rights, equipment and machinery; and (ii) a securities account pledge which includes a pledge over shares or other financial securities and a pledge over the bank account on which cash proceeds relating to such shares/financial securities are credited (such as dividends).

3.3 Can collateral security be taken over real property (land), plant, machinery and equipment? Briefly, what is the procedure?

Collateral security can be taken over real property (land or buildings) by way of a mortgage (*hypothèque*), a lender's lien (*privilege du prêteur de deniers*) or a real estate pledge (*gage immobilier*). These security interests must be entered into by way of a notarised deed and must be registered with the relevant land registry.

Collateral can also be taken over machinery and equipment by way of a pledge, but (if not included in a pledge over business as a going concern) only in favour of certain beneficiaries among which the vendor of the machinery and equipment, and the lender having made available the facilities used to finance the acquisition of the machinery and equipment. The pledge agreement relating to machinery and equipment must be entered into within a maximum period of two months following the delivery of the machinery and equipment to the pledgor and must be registered with the relevant commercial registry within 15 days from its execution for validity purposes.

3.4 Can collateral security be taken over receivables? Briefly, what is the procedure? Are debtors required to be notified of the security?

Yes, collateral can be taken over receivables by way of: (i) a pledge over receivables; (ii) an assignment of receivables by way of security (*Dailly* assignment); (iii) a delegation (*délégation*); or (iv) a security trust (*fiducie-sûreté)*.

A pledge over receivables may be granted by an obligor in favour of any type of beneficiaries (as opposed to a *Dailly* assignment of receivables – see the paragraph below). The notification of the pledge to the debtor(s) is required in order to render the pledge enforceable against the debtor(s), but not for validity purposes. As from such notification, the debtor(s) must make payments directly to the secured creditor, unless otherwise agreed in the pledge agreement.

A *Dailly* assignment of receivables by way of security may only be granted by a borrower (and not by a guarantor or a third party security grantor) and only in favour of: (i) a French licensed credit institution (*établissement de credit)*; (ii) a French licensed financial company (*sociéte de financement*); (iii) a foreign financing institution "passported" to carry out banking activities in France under the 2000/12/EC directive; and (iv) the following French alternative investment entities: professional specialised investment funds (*fonds professionnels spécialisés – FPS*); professional private equity investment funds (*fonds professionnels de capital investissement – FPCI*); French limited partnerships (*sociétés de libre partenеriat – SLP*); securitisation vehicles (*organismes de titrisation – OT*); and specialised financing vehicles (*organismes de financement spécialisés – OFS*). The notification of the assignment to the debtor(s) of the assigned receivables is required in order to render the assignment enforceable against such debtor(s), but not for validity purposes.

A delegation of receivables is generally used to take security over receivables under insurance policies or vendor warranties. The parties to the delegation agreement are not only the delegating obligor (*délégant*) and the secured creditor (*délégataire*), but also the debtor (*délégué*) and therefore no notification of the latter is required. Under a delegation agreement, the debtor agrees to make direct payments to the secured creditor.

A security trust (*fiducie-sûreté*) over receivables may also be granted. The notification of the security trust (*fiducie-sûreté*) to the debtor(s) is also required in order to render the security trust (*fiducie-sûreté*) enforceable against the debtor(s), but not for validity purposes.

3.5 Can collateral security be taken over cash deposited in bank accounts? Briefly, what is the procedure?

A pledge over the balance of a bank account is possible under French law. No particular formalities are required in connection therewith, although the bank account holder is usually notified of the pledge so as to render such pledge enforceable against such person. A pledge may also be granted over cash (*gage-espèces*) by transferring the ownership of such cash to the secured creditor who may then freely dispose of it, subject to returning the same amount of cash to the pledgor upon discharge of all the secured liabilities.

3.6 Can collateral security be taken over shares in companies incorporated in your jurisdiction? Are the shares in certificated form? Can such security validly be granted under a New York or English law governed document? Briefly, what is the procedure?

Collateral security can be taken over shares in companies incorporated in France either by way of a securities account pledge with respect to shares of a joint stock company (a *société anonyme*, a *société par actions simplifiée* or a *société européenne*) or by way of a share pledge with respect to other type of companies (such as a *société à responsabilité limitée*, a *société en nom collectif* or a *société civile*, etc.).

A securities account pledge is a pledge over a securities account in which shares (and/or other securities) are credited and over a cash proceeds account in which dividends or other cash proceeds relating to such shares (and/or other securities) are credited. The securities account is either held by the company whose shares are pledged or by a financial institution. Such security interest automatically extends to any additional shares and any additional cash proceeds which are credited to the pledged accounts during the life of the pledge. In order for such pledge agreement to be valid under French law, a mandatory form of statement of pledge (*déclaration de nantissement*) must be signed by the pledgor. It is also customary for the securities account holder and the cash proceeds account holder to sign acknowledgments of the pledge.

A share pledge actually pledges the shares (as opposed to the pledge of a securities account in which such shares are credited, as explained above with respect to securities account pledges) and therefore new additional shares are not included automatically in the scope of the pledge. It may also cover cash proceeds related to the pledged shares, but only if this is expressly specified in the pledge agreement. In addition to the registration of such pledge with the clerk of the relevant commercial court as mentioned below, other perfection formalities may be required depending on the type of company whose shares are pledged. For instance, a pledge over the shares of a *société civile* must be notified by bailiff (*signifiée par huissier*) to the company whose shares are pledged.

Shares of French companies are not in certificated form, but in dematerialised form. The pledge must be registered (i) with respect to shares of joint stock companies, in the share transfer registry (*registre des mouvements de titres*) and the shareholders' accounts (*comptes d'actionnaires*) of the company whose shares are pledged, and (ii) with respect to shares of other type of companies, in a special register held by the clerk of the relevant commercial court where the company whose shares are pledged is registered.

It is not recommended to have a securities account pledge or a share pledge governed by New York or English law because of difficulties, both practical and legal, which would arise with respect to the perfection and the enforcement of such security interests.

3.7 Can security be taken over inventory? Briefly, what is the procedure?

Yes, security can be taken over inventory. A recent reform has introduced more flexibility for this type of security interest. The parties may now choose between a pledge over inventory governed by the provisions of the French commercial code or a pledge over inventory governed by the provisions of the French civil code.

As opposed to a pledge over inventory governed by the provisions of the French civil code, the pledge over inventory governed by the provisions of the French commercial code may only be granted by a borrower (and not by a guarantor or a third-party security grantor) and only in favour of French licensed credit institutions (*établissements de crédit*), French licensed financing companies (*sociétés de financement*) or foreign financing institutions "passported" to carry out banking activities in France under the 2000/12/EC directive.

Both types of pledge (i) may be enforced through private foreclosure (*pacte commissoire*), and (ii) must be registered for enforceability against third parties (*opposabilité aux tiers*) purposes with the French commercial registry.

3.8 Can a company grant a security interest in order to secure its obligations (i) as a borrower under a credit facility, and (ii) as a guarantor of the obligations of other borrowers and/or guarantors of obligations under a credit facility (see below for questions relating to the giving of guarantees and financial assistance)?

Yes, subject to corporate benefit and financial assistance rules and save for the lenders' lien (*privilège du prêteur de deniers*), the pledge over machinery and equipment, the pledge over inventory governed by the provisions of the French commercial code or the *Dailly* assignment of receivables by way of security which may only be granted in order to secure the grantor's obligations as borrower.

3.9 What are the notarisation, registration, stamp duty and other fees (whether related to property value or otherwise) in relation to security over different types of assets?

The most expensive fees are those relating to security interests over real estate properties. Registration costs and notary fees with respect to a mortgage are calculated as a percentage of the secured amounts and are therefore expensive (as of 1 February 2019, these costs include land registry tax fees (*taxe de publicité foncière*) of 0.715% of the secured amount, plus land registrar's fees (*contribution de sécurité immobilière*) of 0.05% of the secured amount, plus statutory notary fees of 0.447% of the secured amount (for a secured amount exceeding €60,000) (the statutory notary fees may be negotiated since a recent reform implemented in 2016 and discounts may be obtained in certain circumstances), plus a fee of €125 for the registration of the mortgage with the French tax authorities). The costs relating to a lenders' lien (*privilège du prêteur de deniers*) are also based on the secured amount but are not as high as the registration costs of a mortgage, as they do not include the 0.715% mandatory fees corresponding to the land registry tax fees (*taxe de publicité foncière*).

Registration fees with respect to a pledge over intellectual property rights are not expensive unless the pledge covers an important number of intellectual property rights and the accelerated registration procedure is chosen, as opposed to the ordinary registration procedure (the ordinary registration procedure may take between three and five months while the accelerated registration procedure takes up to one week). The cost for the registration under the ordinary procedure is €27 per intellectual property right with a maximum amount of €270 and the cost for the registration under the accelerated procedure is an additional €52 per intellectual property right with no maximum amount.

The registration fees with respect to other types of security interests are not significant: e.g., registration costs with the commercial court of Paris of a pledge over business as a going concern, a pledge over inventory, a pledge over machinery and equipment or a pledge over shares (other than shares of a joint-stock company which do not require registration with a public register) amount to approximately €145 for each pledge (for an amount of the secured obligations exceeding €41,600). The commercial courts may require, prior to the registration of the above-mentioned security interests with the relevant commercial registry, a registration of such security interest agreements with the tax authorities – the cost of such registration is not significant (€125 for each security interest agreement).

3.10 Do the filing, notification or registration requirements in relation to security over different types of assets involve a significant amount of time or expense?

Generally no, save for (i) security over real estate properties with respect to which registration requirements involve a significant amount of expense (see above), and (ii) a pledge over intellectual property rights which may take up to five months if the ordinary procedure is chosen or may be expensive if the accelerated procedure is chosen (please see question 3.9 above).

3.11 Are any regulatory or similar consents required with respect to the creation of security?

No, but it should be noted that the granting of a share pledge or a securities account pledge may require the prior consultation of the works council of the company whose shares are pledged (if such works council exists and if the pledge is over more than 50% of the shares of such company). The opinion of the works council is not binding, but its consultation is mandatory and may take from 15 days to four months depending on the complexity of the contemplated transaction.

3.12 If the borrowings to be secured are under a revolving credit facility, are there any special priority or other concerns?

No, there are not.

3.13 Are there particular documentary or execution requirements (notarisation, execution under power of attorney, counterparts, deeds)?

A security interest agreement over real estate property requires notarisation. If such agreement is signed under a power of attorney, such power of attorney agreement must also be notarised.

French law agreements may not be signed in counterparts.

4 Financial Assistance

4.1 Are there prohibitions or restrictions on the ability of a company to guarantee and/or give security to support borrowings incurred to finance or refinance the direct or indirect acquisition of: (a) shares of the company; (b) shares of any company which directly or indirectly owns shares in the company; or (c) shares in a sister subsidiary?

(a) Shares of the company

Yes, a French joint stock company (a *société anonyme*, a *société par actions simplifiée* or a *société européenne*) may not provide any financial assistance in the form of a loan, guarantee or security interest for the acquisition of its own shares. The violation of this prohibition may lead to the criminal liability of the managers/directors of such company and to the voidability of such loan, guarantee or security interest agreement.

(b) Shares of any company which directly or indirectly owns shares in the company

The prohibition of financial assistance would also apply in case of the acquisition of shares in a company which directly or indirectly holds shares in the company.

(c) Shares in a sister subsidiary

There is no financial assistance prohibition as such, but this type of transaction remains subject to the corporate benefit rules described above.

5 Syndicated Lending/Agency/Trustee/ Transfers

5.1 Will your jurisdiction recognise the role of an agent or trustee and allow the agent or trustee (rather than each lender acting separately) to enforce the loan documentation and collateral security and to apply the proceeds from the collateral to the claims of all the lenders?

France has not ratified the Hague Convention on the Law Applicable to Trusts and on their Recognition. However, in a 2011 case, the French Supreme Court recognised the filing of claims in a bankruptcy proceeding by a New York law security trustee, but there is no case law yet with respect to the enforcement of the loan documentation and related collateral security by a trustee.

The role of an agent in a parallel debt mechanism, as well as the parallel debt mechanism itself, has also been recognised by the above-mentioned case law of the French Supreme Court and may therefore be an alternative to the trust mechanism in credit agreements.

The agent concept is very largely used in French syndicated loans. It is, however, usually based on a power of attorney granted by the lenders and not on specific agency provisions. Although a special security agent regime has been introduced in France in 2007, it has been rarely used as it was more restrictive than the use of a power of attorney. However, a recent reform of the security agent regime, which came into force on 1 October 2017, amended some of the previous restrictive provisions and introduced new useful provisions relating to the rights of the security agent in France, among which are: (i) the possibility to appoint the security agent in any type of agreement including intercreditor agreements (while in the previous regime it could only be appointed in the agreement setting out the secured obligations); (ii) a widening of the scope of the security agent's regime to all security interests and guarantees (while in the previous regime its scope was limited to security interests *in rem*);

(iii) the possibility for the security agent to carry out the registration of the security interests acting in its own name for the benefit of the secured creditors; and (iv) the creation of a concept of separate trust estate (*patrimoine d'affectation*) of the security agent different from its own estate and not impacted by the opening of French insolvency proceedings against the security agent.

5.2 If an agent or trustee is not recognised in your jurisdiction, is an alternative mechanism available to achieve the effect referred to above which would allow one party to enforce claims on behalf of all the lenders so that individual lenders do not need to enforce their security separately?

See the answer to question 5.1 above.

5.3 Assume a loan is made to a company organised under the laws of your jurisdiction and guaranteed by a guarantor organised under the laws of your jurisdiction. If such loan is transferred by Lender A to Lender B, are there any special requirements necessary to make the loan and guarantee enforceable by Lender B?

A loan may be transferred in France by way of (i) assignment (which is the method generally used), (ii) novation, (iii) transfer of agreement (*cession de contrat*), or (iv) transfer of debt (*cession de dette*).

Since the French civil code reform entered into force on 1 October 2016, a transfer made by way of assignment is no longer required to be notified to the French borrower(s) by bailiff (*signification par huissier*) (or alternatively to have such transfer agreement signed by the French borrower(s) in a notarised form). A simple notification of the French borrower(s) by any other means is now sufficient (or the signing by the French borrower(s) of the transfer agreement in a form which does no longer require to be notarised). Such notification (or signing of the transfer agreement by the French borrower(s)) is also required in case of a transfer of the loan by way of a transfer of agreement (*cession de contrat*) or by way of a transfer of debt (*cession de dette*).

If the transfer of the loan is made by way of novation, transfer of agreement (*cession de contrat*) or transfer of debt (*cession de dette*), the consent of the debtor is required. Also the consent of the guarantor(s) as well as the consent of the security provider(s) is required in order for Lender B to be able to enforce its rights under the guarantee or under the relevant security interests. Such consents may be granted concomitantly with the transfer or prior to such transfer (such prior consent may also be provided in the loan agreement and/or in the guarantee/security interest agreement).

In order for Lender A to be discharged from its obligations under the loan agreement in case of a loan transfer by way of a transfer of agreement (*cession de contrat*) or by way of a transfer of debt (*cession de dette*), an express consent of the debtor to such discharge must also be obtained.

6 Withholding, Stamp and Other Taxes; Notarial and Other Costs

6.1 Are there any requirements to deduct or withhold tax from (a) interest payable on loans made to domestic or foreign lenders, or (b) the proceeds of a claim under a guarantee or the proceeds of enforcing security?

(a) Interest payable on loans made to domestic or foreign lenders

Interest paid to French tax resident individuals: As of 1 January 2018, such payments are subject to personal income tax in the hands of the individuals under a flat tax with a rate of 12.8%, unless they elect for the progressive tax schedule for all their investment income. The paying establishment will withhold a compulsory tax advance at a rate of 12.8%, which will later be offset against the final income tax charge due by the lender (12.8% flat tax or progressive tax schedule). In addition to the income tax, social contributions are levied at the rate of 17.2%.

Interest paid to French tax resident companies: As a matter of principle, such payments are not subject to any withholding tax (**WHT**).

Interest paid to foreign lenders (individuals or companies): Such payments do not give rise to any French WHT.

Interest paid to a Non Cooperative State or Territory (**NCST**): As a general rule, a 75% WHT applies in cases where interest is paid to an account located in a NCST (notwithstanding the tax residency of the corporate/individual lender), unless the French debtor can demonstrate that the operations in respect of which the interest is paid have a main purpose and effect other than allowing their localisation in a NCST. However, please note that if the lender is tax resident in a country that has entered into a double tax treaty with France, the provisions of that treaty (if available) may permit the reduction of the rate (down to nil) of such WHT. The list of NCSTs, as updated annually by the French government, currently comprises the following jurisdictions (as of 1 January 2019): Botswana; Brunei; Guatemala; the Marshall Islands; Nauru; Niue; and Panama.

(b) Proceeds of a claim under a guarantee or the proceeds of enforcing security

As a matter of principle, proceeds deriving from a claim under a guarantee or as a result of enforcing security are not subject to WHT in France (irrespective of the tax residence of the beneficiary).

However, it should be noted that:

- Proceeds resulting from the enforcement of a security, in cases where the security grantor is not a French tax resident, may be subject to capital gains WHT (provided that a capital gain is realised upon the sale of the asset on which the security is taken) at rates that vary depending on the nature of the asset. However, if the security grantor is tax resident in a country that has entered into a double tax treaty with France, the provisions of that treaty (if available) may permit the avoidance of (or at least, reduce the cost of) the WHT.
- When the proceeds deriving from enforcing a security are used to pay interest accrued under a loan agreement, the rules indicated in question 6.1 (a) above are applicable.
- Proceeds resulting from a claim under a guarantee are of a *sui generis* nature, but in the case where the purpose of the guarantee is to ensure (in part or in total) the payment of interest accrued under a loan agreement entered into between a French debtor and a foreign beneficiary, it cannot be totally excluded that such guarantee payments would be viewed (at least in part) as interest payments and accordingly be subject to French interest WHT (under the rules summarised in question 6.1 (a) above). There is, however, no firm position of the French tax authorities in this respect, nor relevant case law on the matter.

6.2 What tax incentives or other incentives are provided preferentially to foreign lenders? What taxes apply to foreign lenders with respect to their loans, mortgages or other security documents, either for the purposes of effectiveness or registration?

(a) Incentives attributed to foreign lenders

The absence of WHT on interest (subject to the NCST exception) is very attractive for foreign lenders.

In addition, it is worth mentioning that interest payments made to an account located in a NCST or to a beneficiary residing or located in a NCST as remuneration of a loan agreement entered into outside of France either (i) before 1 March 2010 provided that the expiry date has not since been extended, or (ii) as of 1 March 2010 if said agreement is assimilated to an agreement entered into before that date, are also exempt from WHT in France.

(b) Taxes applicable to foreign lenders with respect to their loans, mortgages or other security documents, either for the purposes of effectiveness or registration

The same taxes apply to all lenders irrespective of whether they are French or foreign with respect to their loans, mortgages or other security documents for the purposes of effectiveness or registration – see the answer to question 3.9 above for details with respect to taxes in relation to registration with the tax authorities (if required).

6.3 Will any income of a foreign lender become taxable in your jurisdiction solely because of a loan to, or guarantee and/or grant of, security from a company in your jurisdiction?

No, it will not.

6.4 Will there be any other significant costs which would be incurred by foreign lenders in the grant of such loan/guarantee/security, such as notarial fees, etc.?

No other significant costs would be incurred by foreign lenders in the grant of such loan/guarantee/security (other than those mentioned above which apply to all lenders, irrespective of whether they are French or foreign). However, translation costs may be incurred with respect to security interests which require registration in a public register, if the security agreements are not already drafted in the French language.

6.5 Are there any adverse consequences for a company that is a borrower (such as under thin capitalisation principles) if some or all of the lenders are organised under the laws of a jurisdiction other than your own? Please disregard withholding tax concerns for purposes of this question.

No: thin capitalisation rules and other rules limiting tax deductibility of interest expenses apply irrespective of the lender's place of residence.

7 Judicial Enforcement

7.1 Will the courts in your jurisdiction recognise a governing law in a contract that is the law of another jurisdiction (a "foreign governing law")? Will courts in your jurisdiction enforce a contract that has a foreign governing law?

Under French law, a contract is governed by the law chosen by the parties.

This principle has been established by the Convention on the law applicable to contractual obligations of 19 June 1980 (the "**Rome Convention**") in relation to contracts entered into before 17 December 2009 and Regulation 593/2008 of 17 June 2008 on the law applicable to contractual obligations (the "**Rome I Regulation**") in relation to contracts entered into after 17 December 2009, which are applicable in France.

(a) Contracts entered into before 17 December 2009

French courts will enforce the foreign law chosen by the parties to contracts entered into before 17 December 2009 in accordance with the Rome Convention, subject to:

- the overriding mandatory rules (*lois de police*) of the law of another country with which the situation has a close connection, if, and insofar as, under the law of the latter country, those rules must be applied whatever the law applicable to the contract; and
- overriding mandatory provisions applicable in France irrespective of the law otherwise applicable to the contract.

In addition, notwithstanding any choice of law clause, in purely domestic contracts, i.e., where all the elements relevant to the situation (apart from the chosen law) are connected with one country only, the mandatory rules of said country shall be applicable.

(b) Contracts entered into after 17 December 2009

French courts will enforce the foreign law chosen by the parties to contracts entered into after 17 December 2009 in accordance with the Rome I Regulation, subject to:

- French overriding mandatory provisions (*lois de police*); and
- the overriding mandatory provisions of the law of the country where the obligations arising out of the contract have to be or have been performed, in so far as those overriding mandatory provisions render the performance of the contract unlawful.

In addition, notwithstanding any choice of law clause, in purely domestic contracts, i.e., where all the elements relevant to the situation (apart from the chosen law) are connected to one country only, the mandatory rules of said country shall be applicable.

7.2 Will the courts in your jurisdiction recognise and enforce a judgment given against a company in New York courts or English courts (a "foreign judgment") without re-examination of the merits of the case?

The criteria relating to the recognition and enforcement in France of judgments rendered by foreign courts vary depending on (i) the country where such judgments were rendered, and (ii) the time when they were rendered:

- judgments rendered within one of the Member States of the European Union **before 10 January 2015** are enforced in France in accordance with the Council Regulation 44/2001 of 22 December 2000 on Jurisdiction and the Recognition and Enforcement of Judgments in Civil and Commercial Matters ("**EC Regulation 44/2001**");
- judgments rendered within one of the Member States of the European Union **after 10 January 2015** are enforced in France in accordance with the Council Regulation 1215/2012 of 12 December 2012 ("**EC Regulation 1215/2012**");
- judgments rendered in countries with which France has signed a bilateral treaty are recognised and enforced in France in accordance with the provisions of the relevant treaty; and
- judgments rendered in countries with which France has not signed bilateral treaties, which is the case for the United States, require a specific procedure for their recognition and enforcement, namely the exequatur decision.

(a) Recognition and enforcement of a judgment given against a company in English courts

Judgments rendered <u>before</u> 10 January 2015

Under EC Regulation 44/2001, a simplified procedure, known as 'declaration of enforceability', is used to enforce judgments rendered by the EU Member States' courts. As a matter of principle, judgments rendered by the courts of a given Member State should circulate freely in other Member States. Accordingly, judgments made by the courts of a Member State shall be declared enforceable in another Member State, immediately upon production of certain documents.

The declaration of enforceability is granted in summary *ex parte* proceedings (*sur requête*) before the clerk (*greffier en chef*) of the relevant *Tribunal de grande instance* (article 509–2 paragraph 1 of the French Civil Procedure Code). The clerk does not check the validity of the judgment and must declare the judgment enforceable when provided with a request to that end as well as with (i) a copy of the judgment which satisfies the conditions necessary to establish its authenticity, and (ii) a certificate made by the competent authority certifying that the judgment is enforceable in its country of origin. Also, certain clerks (for instance, the clerk of the *Tribunal de grande instance de Paris*) must be provided with a certified translation of these documents.

An appeal may be lodged before the relevant *Cour d'appel* within one month as from the notification of the declaration of enforceability. At this stage, the appellant will be able to argue that the judgment should not be granted leave to enforce based on one or more of the limited grounds set out under Articles 34 and 35 of EC Regulation 44/2001 (relating to due process, public policy, and the incompatibility with earlier decisions). These grounds are more restrictive than those applicable to the standard exequatur procedure.

Judgments rendered after 10 January 2015

Under EC Regulation 1215/2012, judgments rendered in civil and commercial matters by the courts of a given Member State are directly enforceable in France (Article 39 of Regulation 1215/2012), provided that two conditions are met, namely: (i) that a French bailiff is provided with a copy of the original decision and a certificate filed by the jurisdiction having rendered the decision (found under Appendix I to Regulation 1215/2012); and (ii) that this certificate is duly served upon the person against whom enforcement is sought, together with the decision (if not already served). This second criterion is not applicable to conservatory measures, except where the measure was ordered by a court without the defendant being summoned to appear.

An application for the refusal of enforcement may be lodged before the enforcement judge ("*juge de l'exécution*"). Please note that for the seizure of salaries, however, the competent court is the instance court ("*tribunal d'instance*"). At this stage, the appellant will be able to argue that the judgment should not be enforced based on one or more of the limited grounds set out under Articles 45 of EC Regulation 1215/2012 (relating to due process, public policy, and the incompatibility with earlier decisions).

(b) Recognition and enforcement of a judgment given against a company in New York courts

In the absence of a treaty signed between France and the United States, the procedure for the enforcement of judgments rendered by New York courts requires a formal writ of summons. Foreign judgments may be enforced in France only once exequatur (also known as the *formule exécutoire*) is granted by the *Tribunal de grande instance* of the defendant's residence (or, if the debtor is not resident in France, the place where his assets are located).

Pursuant to article 509 of the French Code of civil procedure, the following tests must be met in order for a French court to grant an exequatur order with respect to a foreign judgment:

- the court rendering the judgment had jurisdiction over the defendant;
- the foreign court had not been used fraudulently to escape the jurisdiction of a court more closely related to the dispute (i.e., for forum shopping); and
- the foreign judgment was consistent with French international public policy, including due process.

If the French court is satisfied as to the above, the judgment given against a company in New York courts will be granted exequatur without any review of the facts or legal merits.

7.3 Assuming a company is in payment default under a loan agreement or a guarantee agreement and has no legal defence to payment, approximately how long would it take for a foreign lender to (a) assuming the answer to question 7.1 is yes, file a suit against the company in a court in your jurisdiction, obtain a judgment, and enforce the judgment against the assets of the company, and (b) assuming the answer to question 7.2 is yes, enforce a foreign judgment in a court in your jurisdiction against the assets of the company?

If a company is in payment default, a lender may use the fast-track procedure known as *référé-provision* available for the recovery of debts which are not challengeable on serious grounds.

If the amounts are found to be indisputably due, the president of the *Tribunal de Commerce* orders the payment of the debt by an order (*ordonnance de référé*) which has the advantage of being immediately enforceable, notwithstanding an appeal that may be lodged. It should, however, be noted that pursuant to Article 524 of the French Code of civil procedure, a stay of enforcement can be ordered by the *Premier Président de la Cour d'appel* if the due process ("*principe du contradictoire*") has been breached and if the provisional enforcement is likely to result in clearly excessive consequences. *Ordonnances de référé* may in any case be appealed within 15 days (plus two additional months if the appellant's residence is located abroad). Such appeals are heard relatively rapidly by the *Cour d'appel*. There may be a further challenge by a *pourvoi* before the *Cour de cassation* and in such case the decision of the *Cour de cassation* may take up to one year.

Notwithstanding the above, lenders can always go through normal proceedings to obtain payments due under a loan agreement or a guarantee agreement, which may last between 12 and 18 months in the first instance. The enforcement of non-European judgments may also be of the same duration.

It should also be noted that an International Chamber of the Paris Court of Appeal (*Chambre internationale de la Cour d'appel de Paris*), also referred to as CCIP-CA, has recently been created. One of the specificities of this Court is the possibility for a pre-trial judge (*conseiller de la mise en état*) to set a binding, mandatory procedural timetable for the parties in order to speed up the proceedings. In addition, the use of English language is facilitated – documents in English may be submitted to the Court, judgments may be translated and simultaneous translations may be organised during the debates.

7.4 With respect to enforcing collateral security, are there any significant restrictions which may impact the timing and value of enforcement, such as (a) a requirement for a public auction, or (b) regulatory consents?

French law security interests may only be enforced upon the occurrence of a payment default (either resulting from a non-payment of interest, fees or principal or following an acceleration of the secured facilities) and not upon the occurrence of any event of default.

Enforcement of a pledge may be carried out under French law either through judicial foreclosure or public auction or by way of private foreclosure. Enforcement through judicial proceedings (i.e., judicial foreclosure or public auction) may take a significant amount of time

(12–18 months with respect to a mortgage or up to 12 months for other types of security interests), whereas enforcement through private foreclosure may generally take up to two weeks.

The enforcement of a securities account pledge granted over the shares of a listed company may require a regulatory consent from the French stock exchange regulator (*Autorité des Marchés Financiers*) if the pledge is enforced through private foreclosure over more than 30% of the shares of the listed company. Under French takeover rules, where a person, acting alone or in concert, comes to hold directly or indirectly more than 30% of a company's equity securities or voting rights, such person is required, on its own initiative, to inform the French stock exchange regulator immediately and to file an offer for all the company's equity securities. In order to avoid the obligation to file a mandatory bid, an authorisation may be requested from the French stock exchange regulator to temporarily cross the 30% threshold upwards. Such an authorisation may be granted provided that the lenders undertake to sell the shares held in excess of the 30% threshold within a six-month period.

7.5 Do restrictions apply to foreign lenders in the event of (a) filing suit against a company in your jurisdiction, or (b) foreclosure on collateral security?

There are no specific restrictions applying to foreign lenders in the event of filing suit against a company in France or foreclosure on collateral security. It should, however, be noted that for the writ of summons before the Commercial Court ("*tribunal de commerce*") to be valid, the foreign plaintiff has to elect domicile in France.

7.6 Do the bankruptcy, reorganisation or similar laws in your jurisdiction provide for any kind of moratorium on enforcement of lender claims? If so, does the moratorium apply to the enforcement of collateral security?

Yes, the opening of certain bankruptcy proceedings – safeguard proceedings (*sauvegarde*), accelerated safeguard proceedings (*sauvegarde accélérée*), accelerated financial safeguard proceedings (*sauvegarde financière accelérée*), judicial administration proceedings (*redressement judiciaire*) or liquidation proceedings (*liquidation judiciaire*) – provide for a moratorium of enforcement with respect to lender claims and collateral security (save for collateral security created under a *Dailly* assignment of receivables, a cash collateral agreement (*gage-espèces*), a receivables delegation agreement (*délégation de créances*) or a *fiducie* agreement (but only in the case of a so-called possessory *fiducie* (*fiducie avec dépossession*) whereby the assets are effectively transferred to the *fiduciaire*)).

7.7 Will the courts in your jurisdiction recognise and enforce an arbitral award given against the company without re-examination of the merits?

French courts do not carry out a judicial review of the merits of arbitral awards. They only play a supervision function regarding the validity of arbitral awards for which recognition and enforcement are sought in France. Pursuant to the French Civil Procedure Code, a French court can set aside an arbitral award only if:

- the arbitral tribunal wrongly upheld or declined jurisdiction;
- the arbitral tribunal was not properly constituted (i.e. it was irregularly composed or the sole arbitrator was irregularly appointed);
- the arbitral tribunal ruled without complying with the mandate conferred upon it;
- due process (*principe du contradictoire*) was not respected; or
- recognition or enforcement of the award would be contrary to international public policy (*ordre public international*).

8 Bankruptcy Proceedings

8.1 How does a bankruptcy proceeding in respect of a company affect the ability of a lender to enforce its rights as a secured party over the collateral security?

See the answer to question 7.6 above.

8.2 Are there any preference periods, clawback rights or other preferential creditors' rights (e.g., tax debts, employees' claims) with respect to the security?

If a security interest is granted by a French company during a so-called hardening period (*période suspecte*), such security interest may be declared null and void if (i) it has been granted in order to secure a previously incurred debt, or (ii) it has been granted in order to secure a current or future debt, but the beneficiary of the security had knowledge of the insolvency of the grantor. The hardening period is a period set by the bankruptcy court during which the guarantor/pledgor is deemed to be insolvent. According to the French law insolvency test (*cessation des paiements*), a company is insolvent if it is unable to pay its liabilities as they fall due with its immediately available assets (cash or other liquidity assets). A French bankruptcy court may set the insolvency date of a company as far as 18 months prior to the date on which the company has filed for insolvency.

French law provides for preferential creditor rights with respect to: employees' claims; legal expenses; new loans made available during a court-approved conciliation proceeding; security interests over real estate property; and security interests benefiting from a retention right (such as a share pledge, a securities account pledge or a bank account pledge).

8.3 Are there any entities that are excluded from bankruptcy proceedings and, if so, what is the applicable legislation?

Entities regulated by public law (*personnes morales de droit public*) (such as *collectivités territoriales* or *établissements publics*) are excluded from bankruptcy proceedings.

Entities which are not registered with the commercial register and do not have a legal personality (such as *sociétés en participation, sociétés de fait, sociétés en formation*) are also excluded from bankruptcy proceedings.

8.4 Are there any processes other than court proceedings that are available to a creditor to seize the assets of a company in an enforcement?

Yes, private foreclosure (*pacte commissoire*) is permitted under French law with respect to almost all types of security interests, save for certain exceptions such as a pledge over business as a going concern.

However, enforcement by private foreclosure is prohibited during certain insolvency and pre-insolvency proceedings such as safeguard proceedings, accelerated safeguard proceedings, accelerated financial safeguard proceedings, judicial administration proceedings and judicial liquidation proceedings.

9 Jurisdiction and Waiver of Immunity

9.1 Is a party's submission to a foreign jurisdiction legally binding and enforceable under the laws of your jurisdiction?

French law allows considerable freedom to the parties to a contract in selecting a jurisdiction for their disputes, with the notable exception of disputes relating to real property, which must be resolved by the appropriate court at the place where the property is located.

The choice of a foreign jurisdiction is valid provided that:

- the dispute is international, it being specified that French courts do not require that the dispute has a material link to the foreign jurisdiction chosen by the parties;
- the jurisdiction choice clause does not preclude the mandatory exclusive jurisdiction of a French court in relation to certain aspects (e.g. in relation to employment contracts); and
- the clause is not a unilateral dispute resolution clause giving only one party the choice between several jurisdictions while the other party is bound to bring actions before one jurisdiction only (this principle was recently confirmed by a decision rendered by the French Supreme Court on 26 September 2012).

9.2 Is a party's waiver of sovereign immunity legally binding and enforceable under the laws of your jurisdiction?

Waivers of sovereign immunity from jurisdiction are legally binding and enforceable under the laws of France.

But a waiver of sovereign immunity from jurisdiction does not entail a waiver of immunity from execution, which must be separately expressed in order for it to be equally binding and enforceable. A decision of the French supreme court (*Cour de cassation*) dated 13 May 2015 has, until recently, been seen as having overturned the previous requirement for the waiver of immunity from execution to specifically identify the assets or the category of assets in respect of which such waiver is granted.

This was, however, amended on 9 December 2016, following the enactment of the *Loi Sapin 2*, which entered into force on 11 December 2016 and introduced a new authorisation procedure that requires the creditor to seek, in an *ex parte* proceeding, an order for an interim or enforcement measure against the foreign sovereign State.

In this regard, *Loi Sapin 2* provides that interim or enforcement measures relating to property belonging to a foreign sovereign State may only be authorised if one of the following conditions is met:

- the foreign sovereign State has expressly consented to such measure;
- the foreign sovereign State has reserved or assigned the property in accordance with the request; or
- where a judgment or arbitral award has been rendered against the foreign sovereign State and the property at stake is specifically used or intended to be used by that foreign sovereign State otherwise than for the purposes of public service and there is a relationship with the foreign sovereign State entity against which the proceedings were instituted.

A specific regime has also been created by the *Loi Sapin 2* with respect to property (including bank accounts) used in the exercise of diplomatic missions of foreign States by requiring for this category of property an express and special waiver of immunity from the foreign State in order for any interim or enforcement measures to be taken with respect to such property.

Also, the French Supreme Court (*Cour de cassation*) overturned its decision dated 13 May 2015 by a decision dated 10 January 2018 whereby it ruled that a waiver of immunity from execution by a foreign sovereign State may be valid provided that the waiver is express and special, i.e. specifically identifies the assets or the category of assets in respect of which such waiver is granted, thereby complying with the provisions of the *Loi Sapin 2*.

Finally, no interim measures and no enforcement action against property belonging to a foreign sovereign State can be authorised by a French judge in favour of the holder of a debt obligation or an instrument or right with characteristics similar to a debt instrument if:

- the foreign sovereign State was receiving aid from the Development Assistance Committee of the OECD when it issued the debt document;
- the holder of the debt obligation acquired that security when the foreign sovereign State was in default on that debt obligation or proposed a change in the terms of the debt obligation; and
- the default status on the debt obligation is less than 48 months at the time the holder of the debt obligation seeks a court order authorising him to seek an order for enforcement.

10 Licensing

10.1 What are the licensing and other eligibility requirements in your jurisdiction for lenders to a company in your jurisdiction, if any? Are these licensing and eligibility requirements different for a "foreign" lender (i.e. a lender that is not located in your jurisdiction)? In connection with any such requirements, is a distinction made under the laws of your jurisdiction between a lender that is a bank *versus* a lender that is a non-bank? If there are such requirements in your jurisdiction, what are the consequences for a lender that has not satisfied such requirements but has nonetheless made a loan to a company in your jurisdiction? What are the licensing and other eligibility requirements in your jurisdiction for an agent under a syndicated facility for lenders to a company in your jurisdiction?

Pursuant to French banking monopoly rules, an entity which carries out banking activities on a regular basis in France (irrespective of whether such entity is located in or outside of France) in most cases must be either (i) duly licensed as a credit institution (*établissement de crédit*) or as a financing company (*société de financement*) in France, or (ii) duly "passported" under the European Directive 2000/12 to provide such services in France.

Recent reforms have, however, introduced some important exceptions to the French banking monopoly rules:

- The following alternative investment entities are now also authorised, under certain conditions set out in recent decrees nos. 2018-1004 and 2018-1008, to make loans to a French borrower: professional specialised investment funds (*fond professionnels spécialisés – FPS*); professional private equity investment funds (*fonds professionnels de capital investissement – FPCI*); French limited partnerships (*société de libre parteneriat – SLP*); securitisation vehicles (*organismes de titrisation – OT*); and specialised financing vehicles (*organismes de financement spécialisés – OFS*).
- A company may, as an ancillary activity to its main business, grant loans to another company with which it has economic ties justifying the granting of such loans. These provisions have become effective on 22 April 2016 when a decree listing all the conditions to be met for such loans to not fall foul of

the French banking monopoly rules has been published. There are more than 20 conditions which have to be met, including the following:

(a) the maturity of the loan must not exceed two years;

(b) the lender must be a joint stock company (a *société anonyme* or a *société par actions simplifiée*) or a limited liability company (*société à responsabilité limitée*) whose accounts, in each case, are certified by an auditor;

(c) the borrower must be a small or medium-sized company;

(d) the entry into the loan agreement is subject to a specific corporate approval process;

(e) the amount of the loan must be specified in the management report and included in an auditor's certificate; and

(f) the receivables under such loan may not be assigned to securitisation vehicles or to specialised funds or be subject to forward contracts (*instruments financiers à terme*) or instruments used to transfer insurance risks to such securitisation vehicles or specialised funds.

It should also be noted that there are some other limited exceptions to the banking monopoly rules which apply to specific entities or to specific types of loans (such as participating loans (*prêts participatifs*) – long-term subordinated loans with a fixed interest rate which can be granted by a commercial company to another commercial, agricultural or industrial company).

Non-compliance with the French banking monopoly rules may lead to criminal liability, but according to French Supreme Court case law, a banking transaction carried out in violation of the banking monopoly rules remains valid (however, it should be noted that French courts are not bound by precedent).

With respect to licensing requirements for agents, if such agents provide services which are regulated in France such as payment services, these entities are required to be licensed in order to carry out such services in France.

11 Other Matters

11.1 Are there any other material considerations which should be taken into account by lenders when participating in financings in your jurisdiction?

Among the other specificities with respect to French law financing transactions, the following should be taken into account: (1) interest under a French law loan agreement may only be compounded if it has accrued for a period of at least one year; and (2) a special effective global rate (TEG) notice must be sent to French borrowers no later than the day of entering into of the credit agreement.

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1 Overview

1.1 What are the main trends/significant developments in the lending markets in your jurisdiction?

During the second quarter of 2018 there was a significant increase in the volume of lending to companies and self-employed persons in Germany, in particular in the manufacturing industry and in the real estate sector. This increase related mainly to short- and medium-term loans, but less to long-term loans, as companies steadily augmented their liquidity cushions. In the third quarter of 2018, however, there was a downturn in economic performance in Germany, mainly attributable to special developments in the automobile industry. Further, external factors such as geopolitical tensions and trade conflicts had a negative impact on German exports. Nevertheless, access to finance remained favourable throughout the third quarter of 2018. Bank lending to the domestic non-banking sector was less dynamic in Q3 than in Q2. On the other hand, the refinancing conditions for credit institutions are no longer seen as positively as before, although the same are still favourable. Furthermore, interest rates for bank loans to non-financial businesses remained close to their historic lows. The net issuance of bonds (*Schuldverschreibungen*) by non-financial entities increased considerably due to the continuing favourable conditions in bond markets; certain other segments of the market such as export finance still suffer not only from continuing sanctions, but also from the risk of an aggravation of sanctions and related uncertainties.

1.2 What are some significant lending transactions that have taken place in your jurisdiction in recent years?

The acquisition of Monsanto by Bayer, financed by a EUR 51.6 bn loan, was closed in 2018. E.ON successfully completed the syndication of the acquisition financing of EUR 5 bn in connection with the voluntary public takeover offer to the shareholders of innogy SE. German financing was provided for the takeover of USG Corporation by the German competitor Knauf using available cash as well as facilities from Commerzbank and UniCredit. The online trading platform Scout24 was granted a new unsecured syndicated loan of EUR 1 bn by a syndicate led by UniCredit and ABN Amro. The loan served not only the refinancing of existing debt but also the acquisition of the consumer finance platform Finanzcheck.de for a purchase price of EUR 285 mn. The Frankfurt-based creditshelf AG arranged Germany's largest digital SME-financing to date, where EUR 4.75 mn for a buy-out transaction was placed and paid out via the platform in less than two days.

2 Guarantees

2.1 Can a company guarantee borrowings of one or more other members of its corporate group (see below for questions relating to fraudulent transfer/financial assistance)?

It is common in credit agreements under German law that a company guarantees borrowing of other members of its corporate group. Downstream guarantees, in general, do not cause specific problems. In case of upstream and cross-stream guarantees granted by a limited liability company (GmbH) or a stock corporation (AG) or *societas europaea* (SE), capital maintenance rules applicable to the respective guarantor must be observed. The same applies for corporate structures where corporations of the relevant types ultimately assume the liability for the relevant guarantee, e.g. in case of a German law GmbH & Co KG (a limited partnership where a limited liability company is the general partner).

These rules do not only apply to guarantees, but also to other forms of security, including sureties (*Bürgschaften*).

2.2 Are there enforceability or other concerns (such as director liability) if only a disproportionately small (or no) benefit to the guaranteeing/securing company can be shown?

With regard to enforceability of guarantees and other forms of security, including sureties (*Bürgschaften*), certain restrictions have to be observed in order to avoid possible personal liability of the managers of the respective company which has granted security. Differentiation has to be made with regard to the corporate form of the company.

GmbHs: It used to be standard market practice in Germany to include enforcement limitation language in the documentation for upstream and cross-stream guarantees which limits any enforcement action by a secured borrower to free funds of the limited liability company. Such limitation language is included in the relevant guarantee documentation to protect the managing directors of the company against personal liability which could otherwise be triggered in case an enforcement action would result in the share capital of the company falling below the statutory minimum share capital.

For a long time, it was disputed in German legal literature which point in time should be relevant for assessing whether or not a shortfall of the statutory minimum share capital would occur: the point in time when the guarantee is granted or the point in time when it comes to realisation of the guarantee by way of enforcement. According to recent court decisions of the German Federal Supreme Court (*Bundesgerichtshof – BGH*), no liability of the managing director shall be triggered if the manager, after due and diligent assessment of the financial situation of the company, comes to the conclusion that, at the point in time of granting collateral, it can be assumed that the principal debtor will be in a position to repay its borrowing so that the collateral will not have to be realised and no shortfall of the statutory minimum share capital will occur. Although the relevant court decisions do not directly relate to guarantees, this has triggered discussions in the German market regarding the justification and future role of limitation language, and possible adjustments of the existing practice to these new court decisions. It is therefore recommended to seek legal advice to properly address the resulting changes to the legal framework.

GmbH & Co. KG: The explanations above are also true for the general partner of a limited partnership which would ultimately assume the liability for any security granted by the limited partnership.

AG: The capital maintenance rules to be observed in case of an AG are even stricter. In principle, any payments and the granting of any advantages by the company to its shareholders are prohibited (except for the distribution of dividends on the basis of a resolution of the general meeting of the shareholders). Such payments and advantages are only permitted in a limited number of cases, e.g. in case of an existing control and profit transfer agreement or in case the company granting the security has a valid compensation claim against its shareholders.

Societas Europaea (SE): Pursuant to Art. 5 of Council Regulation (EC) No 2157/2001 of 8 October 2001 on the Statute for a European company (SE), the capital of an SE, its maintenance and changes thereto, together with its shares, bonds and other similar securities shall be governed by the provisions which would apply to a public limited liability company with a registered office in the Member State in which the SE is registered. Hence, the rules for German stock corporations apply accordingly on SEs registered in Germany.

2.3 Is lack of corporate power an issue?

Lack of corporate power is generally not an issue. German law does not recognise the concept of "*ultra vires*" for companies (save for certain specific exceptions). Limitations to the managing director's power to represent the company (e.g. based on articles of association or internal rules of procedure for the management) do, in principle, have no effect in relation to third parties. An exception applies if it is obvious for the third party that the managing director has exceeded their authority to represent the corporation (*Evidenz*) or if the managing director and the relevant third party have cooperated in a collusive way to the detriment of the company (*Kollusion*). A further exception applies, at least according to German jurisdiction and legal scholars, to certain legal entities under public law which shall not be in a position to validly enter into legal transactions which go beyond their statutory field of activity.

2.4 Are any governmental or other consents or filings, or other formalities (such as shareholder approval), required?

A guarantor qualifies as a credit institution and hence requires a licence from the German Federal Financial Supervisory Authority (*BaFin*) if it issues guarantees in a commercial manner or in a way which requires a commercial business organisation (§ 31 in conjunction with § 1 para. 1 no. 8 of the Banking Supervisory Act – *Kreditwesengesetz*, "**KWG**"). A guarantor shall, however, not qualify as a credit institution if it conducts the relevant transactions only with its parent company, subsidiaries or sister companies (§ 2 para. 1 no. 7 of the KWG). However, the construction of this so-called group privilege is now much stricter than in former years.

Guarantees issued by private companies are not subject to individual government consent requirements. Exceptions may apply to public entities acting as guarantors, in addition to state aid rules applicable on public and publicly-owned entities.

While there is no statutory requirement for a shareholders' resolution or resolution of the supervisory board or other corporate bodies in case of the assumption of guarantees, the articles of association of the respective corporation may require such consent.

2.5 Are net worth, solvency or similar limitations imposed on the amount of a guarantee?

No, except for the limitations imposed by the capital maintenance rules under German law (*cf.* above under questions 2.1 and 2.2).

2.6 Are there any exchange control or similar obstacles to enforcement of a guarantee?

Under German law, there are generally no exchange controls that would restrict the enforcement of a guarantee.

This is without prejudice to restrictions resulting from existing German or European sanctions legislations, which also affects guarantees.

3 Collateral Security

3.1 What types of collateral are available to secure lending obligations?

Under German law, in principle, all transferable assets are eligible as collateral. Common types of classic security are pledges and transfers and assignments for security purposes in case of movable assets, and mortgages and land charges in case of real property. In addition thereto, there exist certain special types of security rights such as mortgages for aircraft and vessels and other less common types of security, in addition to quasi-security arrangements.

Shares and bank accounts are commonly pledged. Financial institutions usually insist on the use of their own templates for the pledge of accounts held with them. Receivables, claims and intellectual property rights may be assigned as security and the ownership in fixed assets (such as movable property and equipment) is frequently transferred as security. Real property may be encumbered by a mortgage or land charge.

3.2 Is it possible to give asset security by means of a general security agreement or is an agreement required in relation to each type of asset? Briefly, what is the procedure?

Security over different kinds of assets could be created in the same agreement. However, particularities would need to be observed with respect to each asset class and with respect to each type of security. Furthermore, security over real property requires notarial form, for which reason it would be inefficient to combine this in the same document.

It is more common under German law to create collateral in a separate agreement for each type of security, and furthermore the parties may wish to enter into different documents if third parties are involved.

German law does not recognise the concept of floating charges.

3.3 Can collateral security be taken over real property (land), plant, machinery and equipment? Briefly, what is the procedure?

Real property can be encumbered by a land charge (including rent charges) or a mortgage. Land charges are more common because – unlike mortgages – they are independent in their existence from the underlying claim which is secured by them. While a mortgage can only be transferred together with the underlying receivable, a land charge can be created and transferred without the receivable secured by it. Both, mortgages and land charges need to be established in notarised form and registered in the land register to become valid. A land charge can be created without certificate (*Buchgrundschuld*) or as a certified land charge (*Briefgrundschuld*) in which case the handover of the certificate to the beneficiary of the land charge is necessary. A land charge or mortgage also covers appurtenances (*Zubehör*), but attention should be paid to the distinction between immovable and movable assets, e.g. in case of temporary structures.

Ownership of plants, machinery and equipment which are not an essential part of the property can be transferred as security by a simple transfer agreement. Here, special attention should be paid to possible conflicts of different security rights (e.g. conflicts with reservation of title arrangements).

3.4 Can collateral security be taken over receivables? Briefly, what is the procedure? Are debtors required to be notified of the security?

Yes. The common way of creating security over receivables and claims of the debtor is a security assignment which is usually executed in simple written form. The obligor generally does not need to be notified to create a valid assignment, and, according to market practice, many assignments remain undisclosed. However, a notification is required for perfection purposes. Since the obligor may still validly fulfil its obligation by payment to the former creditor (unless the obligor has knowledge of the assignment to the new creditor), it may be advisable to notify the obligor of the assignment in order to mitigate such risk. The relevant receivables to be assigned must be identifiable without doubt, a requirement that requires particular attention in case of future receivables.

Attention should be paid to contractual consent requirements which may apply on the assignment of individual receivables.

3.5 Can collateral security be taken over cash deposited in bank accounts? Briefly, what is the procedure?

The common form to create security over a bank account and cash deposited therein is an account pledge which is generally entered into in simple written form. Most financial institutions insist on the use of their own templates for pledges of accounts held with them. The pledge needs to be notified to the account-holding bank as the obligor. Such notification is a validity requirement.

3.6 Can collateral security be taken over shares in companies incorporated in your jurisdiction? Are the shares in certificated form? Can such security validly be granted under a New York or English law governed document? Briefly, what is the procedure?

With regard to shares in companies, a pledge is the most common form of security. A pledge over shares in a German limited liability company (GmbH) requires notarisation. It is generally not necessary to notify the pledge to the GmbH. However, the articles of association of the GmbH may require the prior consent of the company or its shareholders for a share pledge to become effective. The creation of the pledge is governed by the law governing the company, i.e. in case of a German GmbH by German law. It is not possible to agree on foreign law as the applicable law for the creation of the pledge.

A pledge over shares in a stock corporation may be completed without observing specific formalities. However, any share certificates issued for the relevant shares need to be transferred to the pledgee. Generally, the shares are certificated in one global certificate (*Globalurkunde*) which is deposited with a clearing system. In such case, the (indirect) possession of (parts of) the certificate needs to be transferred, which can be achieved by transferring the respective claim for handover. The creation of the pledge is governed by the law in which the share certificates are situated (*lex rei sitae*), i.e. in case of a German stock corporation the shares of which are deposited in Germany by German law. It is not possible to agree on foreign law as applicable law for the necessary transfer of ownership in the share certificate. In case of registered shares (*Namensaktie*) the transfer/pledge is regularly evidenced on the certificate by way of endorsement (*Indossament*).

3.7 Can security be taken over inventory? Briefly, what is the procedure?

Security transfers are generally used in order to create security over inventory or movable property. A security transfer agreement is generally executed in simple written form. A practical challenge is the precise and identifiable description of the assets, in particular with regard to inventory. In such case, the agreement will frequently be either all-inclusive, refer to a certain area on the business premises and state that title to all assets located therein will be transferred, or list individual inventory in an explicit way.

3.8 Can a company grant a security interest in order to secure its obligations (i) as a borrower under a credit facility, and (ii) as a guarantor of the obligations of other borrowers and/or guarantors of obligations under a credit facility (see below for questions relating to the giving of guarantees and financial assistance)?

Yes, a company can grant security to secure its own obligations as a borrower under a credit facility as well as its obligations as a guarantor for obligations of other borrowers/guarantors. For limitations, please see questions 2.1 and 2.2.

3.9 What are the notarisation, registration, stamp duty and other fees (whether related to property value or otherwise) in relation to security over different types of assets?

Where notarisation is required in order to create security (e.g. pledge of shares in a limited liability company (GmbH) or creation of a land charge or mortgage), notary fees are incurred. The amount of the notary fees depends on the value of the encumbered assets and is calculated according to a statutory fee schedule. In addition, registration fees of the land register will be triggered for the registration of a land charge or mortgage. However, German law does not know the concept of stamp duty.

3.10 Do the filing, notification or registration requirements in relation to security over different types of assets involve a significant amount of time or expense?

Land charges and mortgages need to be registered in a public register. The land register at the local court of the district where the encumbered real estate is situated will be competent for the registration. Depending on the land register in charge and the complexity of the legal questions to be assessed, the registration procedure might take anything from one or two days to several weeks. In case the encumbered real property itself is not yet registered (e.g. in case of the formation of one or more new plots of land as a result of a split, merger or other alteration of existing plots of land), there may be additional time required to effect a necessary land survey, etc.

With regard to expenses, please see our answer to question 3.9.

3.11 Are any regulatory or similar consents required with respect to the creation of security?

No general regulatory or similar consents are required with respect to the creation of security.

With regard to licence requirements applicable on a guarantor that qualifies as a financial institution, and with respect to public or publicly-owned entities, please see the answer to question 2.4.

3.12 If the borrowings to be secured are under a revolving credit facility, are there any special priority or other concerns?

There are generally no special priority or other concerns with regard to security, if borrowings are granted under a revolving credit facility. Under German law, it is even possible to grant security for future obligations and to extend security interest to future-acquired assets (e.g. a future claim or revolving inventory) as long as they can be identified at the time of the conclusion of the security agreement in a manner that ensures their determinability when acquired.

3.13 Are there particular documentary or execution requirements (notarisation, execution under power of attorney, counterparts, deeds)?

Regarding notarisation requirements, please see the answers to questions 3.3 and 3.6. Execution under power of attorney is generally possible. However, notarial certificates of representation might be required if the signatories of the power of attorney are not registered in public registers (e.g. in the commercial register). Powers of attorney which shall be used for real estate transactions and for filings with public registers (commercial register, land register) generally need to be executed in notarial form. For notarisations effected in certain foreign countries, the notarial certification must be accompanied by an apostille.

4 Financial Assistance

4.1 Are there prohibitions or restrictions on the ability of a company to guarantee and/or give security to support borrowings incurred to finance or refinance the direct or indirect acquisition of: (a) shares of the company; (b) shares of any company which directly or indirectly owns shares in the company; or (c) shares in a sister subsidiary?

(a) Shares of the company

For stock corporations, section 71a para. 1 of the German Stock Corporation Act (AktG) contains a strict prohibition to grant a loan or security to third parties in order to enable such third party to acquire shares in the company. This prohibition does not apply in case financial assistance is granted (i) in the course of the regular business of a credit or financial services institution, (ii) on the basis of an existing control and profit and loss transfer agreement, and (iii) in connection with an employee participation programme.

German law does not provide for an explicit prohibition of financial assistance measures for limited liability companies (GmbH). However, the capital maintenance rules applicable to limited liability companies (for details, *cf*. above under questions 2.1 and 2.2) often result in a similar effect.

(b) Shares of any company which directly or indirectly owns shares in the company

For stock corporations, section 71a para. 1 of the German Stock Corporation Act is not directly applicable. However, according to section 71d para. 1 sentence 2 and 4 of the German Stock Corporation Act, the financial assistance rules described above apply accordingly in case a controlled company grants a loan or security to a third party in order to enable such third party to acquire shares in the controlling company.

For limited liability companies, restrictions may result from the capital maintenance rules described above under questions 2.1 and 2.2.

(c) Shares in a sister subsidiary

The financial assistance rules for stock corporates as described above do not directly apply in such a scenario. However, for stock corporations as well as limited liability companies restrictions may result from the general capital maintenance rules (*cf*. questions 2.1 and 2.2 above).

5 Syndicated Lending/Agency/Trustee/Transfers

5.1 Will your jurisdiction recognise the role of an agent or trustee and allow the agent or trustee (rather than each lender acting separately) to enforce the loan documentation and collateral security and to apply the proceeds from the collateral to the claims of all the lenders?

German law generally recognises the role of an agent or trustee, also with regard to the enforcement of security.

Exceptions apply to “accessory” security interest (for details, see the answer to question 5.2).

5.2 If an agent or trustee is not recognised in your jurisdiction, is an alternative mechanism available to achieve the effect referred to above which would allow one party to enforce claims on behalf of all the lenders so that individual lenders do not need to enforce their security separately?

With regard to certain accessory security rights (which are legally inseparable from the secured claim), it is common practice to create, in addition to the underlying secured claim, a parallel debt, i.e. a second claim for the benefit of the security trustee as abstract acknowledgment of debt in the amount of the current or future payment obligations against the finance parties. In order to avoid risks of double payment, the security trustee must not realise its claim under the abstract acknowledgment of debt to the extent the original secured claim has been fulfilled. The parallel debt structure ensures that certain accessory security rights (e.g. pledges, guarantees) are not terminated by operation of law in case of changes to the lenders of a syndicated loan agreement involving the termination of the initial secured claim while creating a new claim with the acquirer. While the validity of parallel debt structures is generally accepted in German legal literature, it has not yet been confirmed by German courts.

5.3 Assume a loan is made to a company organised under the laws of your jurisdiction and guaranteed by a guarantor organised under the laws of your jurisdiction. If such loan is transferred by Lender A to Lender B, are there any special requirements necessary to make the loan and guarantee enforceable by Lender B?

The loan and a guarantee, which by nature are non-accessory, can generally each be transferred by simple assignment agreement. In contrast to a guarantee, a surety (*Bürgschaft*) (which is of an accessory nature) will automatically transfer upon assignment of the secured loan.

Also, with regard to possible defences of a guarantor under German law, differentiation has to be made between guarantees and sureties. While the most common form is the independent (non-accessory) guarantee, the guarantor has only very limited defences in this case. Further details depend on the type of guarantee (e.g. guarantees on first demand, standard guarantees, etc.) involved and the underlying terms of the individual guarantee. In particular, in case of an independent guarantee, the existence of the main debt is not a condition for the guarantor's obligation to pay. Often, the guarantor is restricted to the objection of abuse of law by the creditor.

In contrast thereto, a surety (*Bürge*) can principally invoke all defences and objections of the main debtor. The surety can also refuse payment in case the debtor is entitled to challenge the transaction creating its debt and in case the creditor can satisfy its claim by way of set-off against a claim of the debtor. Further, the surety is generally only obliged to pay the creditor if the creditor cannot realise its claim against the debtor. All these defences are subject to a possible waiver by the surety. However, a waiver might be invalid if agreed upon in general terms and conditions because such waiver would contradict the concept of accessoriness and transform the surety into an instrument that is tantamount to an independent, non-accessory guarantee.

6 Withholding, Stamp and Other Taxes; Notarial and Other Costs

6.1 Are there any requirements to deduct or withhold tax from (a) interest payable on loans made to domestic or foreign lenders, or (b) the proceeds of a claim under a guarantee or the proceeds of enforcing security?

In general, there is no requirement under German tax law to deduct or withhold tax from (a) interest payable on loans made to domestic or foreign lenders, or (b) the proceeds of a claim under a guarantee or the proceeds of an enforcement of security, provided the loan has no profit link feature and is not securitised as a fungible debt instrument.

However, interest payments to a foreign lender may be considered German-sourced income, if the loan is directly or indirectly secured by German-*situs* real property, comparable rights or ships registered in Germany. In such a case, the foreign lender might be under an obligation to file a tax return (at least, where an applicable double taxation agreement also permits Germany to tax such income from interest payments). In such a case, the German tax authorities have the discretion to require the obligor to withhold tax. The tax rate for a corporate taxpayer is 15.825%. Any tax withheld might be credited or refunded upon a tax assessment of the foreign lender.

6.2 What tax incentives or other incentives are provided preferentially to foreign lenders? What taxes apply to foreign lenders with respect to their loans, mortgages or other security documents, either for the purposes of effectiveness or registration?

There are no German tax incentives or other incentives provided to foreign lenders. No taxes apply with respect to their loans, mortgages or other security documents for the purposes of effectiveness or registration.

6.3 Will any income of a foreign lender become taxable in your jurisdiction solely because of a loan to, or guarantee and/or grant of, security from a company in your jurisdiction?

No. The income of a foreign lender will not become taxable in Germany solely because of a loan to or guarantee and/or generally the grant of security from a company in Germany.

However, the income of a foreign lender, notwithstanding the foregoing, may become taxable in Germany in case the loan is secured by real estate in Germany, comparable rights or ships registered in Germany (see above at question 6.1). This does, in general, not apply in case of the existence of a double taxation agreement between Germany and the country of residence of the foreign lender.

Furthermore, the income of the foreign lender may become taxable in Germany in cases where such income is attributable to the business property of a permanent establishment (including a permanent representative) of such a lender in Germany.

6.4 Will there be any other significant costs which would be incurred by foreign lenders in the grant of such loan/guarantee/security, such as notarial fees, etc.?

The costs for foreign lenders will generally not be different from the costs incurred by a German lender. For such costs, please see the answer to question 3.9.

6.5 Are there any adverse consequences for a company that is a borrower (such as under thin capitalisation principles) if some or all of the lenders are organised under the laws of a jurisdiction other than your own? Please disregard withholding tax concerns for purposes of this question.

There are generally no such adverse consequences under German law.

However, in cross-border transactions, there may be conflicting sanction rules, and German law establishes a prohibition to submit to foreign boycotts.

7 Judicial Enforcement

7.1 Will the courts in your jurisdiction recognise a governing law in a contract that is the law of another jurisdiction (a "foreign governing law")? Will courts in your jurisdiction enforce a contract that has a foreign governing law?

According to article 3 para. 1 of regulation (EC) no 593/2008 on the law applicable to contractual obligations (Rome I), which is applicable in Germany, a contract shall be governed by the law chosen by the parties. A specific link to a foreign jurisdiction is generally not required in order for the choice of law to be valid. However, in case the only link to a foreign jurisdiction is the law chosen by the parties, mandatory provisions of the jurisdiction to which the case is linked will apply irrespective of the chosen law. Further, the freedom of choice of law may be limited with regard to collateral and the underlying agreements. For example, *in rem* security is mandatorily governed by the law of the location of the property (*lex rei sitae*).

Apart from the aforementioned limitations, German courts will recognise foreign law chosen by the parties for the contract and enforce the respective provisions.

7.2 Will the courts in your jurisdiction recognise and enforce a judgment given against a company in New York courts or English courts (a "foreign judgment") without re-examination of the merits of the case?

With regard to English courts (as well as courts of other EU Member States), the recognition of judgments is governed by regulation (EU) no 1215/2012 on jurisdiction and recognition and enforcement of judgments in civil and commercial matters. According to article 36 of such regulation, a judgment given in a Member State shall be recognised in the other Member State without any special procedure being required. However, the party who wishes to invoke a judgment given in one Member State in another Member State needs to produce a copy of the judgment which satisfies the conditions necessary to establish its authenticity as well as a certificate to be issued pursuant to article 53 of the regulation containing certain information with regard to the court proceedings. In addition, the court may require the party to provide a translation of the certificate or the judgment. Upon application of a party, the recognition of a judgment may be denied in certain cases, e.g. in case of an evident breach of the German *ordre public* (*cf.* article 45 of the regulation).

With regard to New York courts (as well as courts of non-EU Member States), the recognition of judgments would be governed by the provisions of the German Code of Civil Procedure (ZPO). Such judgments will generally be recognised, subject to limited exceptions, e.g. if the foreign judgment violates the German *ordre public* (*cf.* section 328 ZPO).

7.3 Assuming a company is in payment default under a loan agreement or a guarantee agreement and has no legal defence to payment, approximately how long would it take for a foreign lender to (a) assuming the answer to question 7.1 is yes, file a suit against the company in a court in your jurisdiction, obtain a judgment, and enforce the judgment against the assets of the company, and (b) assuming the answer to question 7.2 is yes, enforce a foreign judgment in a court in your jurisdiction against the assets of the company?

It is difficult to predict how long it would take for a foreign lender to obtain and enforce a judgment or to enforce a German judgment in Germany since the timing will be influenced by different factors, such as the workload of the court, whether the defendant might introduce even unjustified defences, and the complexity of the case. In case a judgment by default can be obtained, the proceedings may only take a couple of weeks. In case of ordinary court or enforcement proceedings, the duration of the proceedings will depend on the individual circumstances of the case, and in particular on the type of defences brought forward by the defendant.

7.4 With respect to enforcing collateral security, are there any significant restrictions which may impact the timing and value of enforcement, such as (a) a requirement for a public auction, or (b) regulatory consents?

Pledged security is generally sold in a public auction which is a formal proceeding and requires prior notification of the owner of the pledged security at least one month before the public auction shall take place. If the asset has a market price, pledged security can be enforced by way of a private sale at the choice of the pledgee. Banks prefer private sales, as they usually lead to better results and are less formalistic.

Land charges and mortgages are enforced by way of a public auction or forced administration in formal proceedings organised and conducted by a special enforcement court. However, the parties may agree on alternative forms of enforcement (e.g., private sale) in order to simplify proceedings and realise better results.

Assigned receivables against third parties are generally realised by collecting them from the debtor, which does not entail specific formalities.

Regulatory consents are generally not required in connection with the enforcement of security except for the providers of debt collection services which need to be registered according to the German Legal Services Act (*Rechtsdienstleistungsgesetz*), which is only possible if certain requirements are met.

7.5 Do restrictions apply to foreign lenders in the event of (a) filing suit against a company in your jurisdiction, or (b) foreclosure on collateral security?

In general, no such restrictions apply to foreign lenders. However, lenders from countries other than EU Member States or Member States of the Hague Convention of 1 March 1954 on Civil Procedure might be obliged to provide collateral for court costs.

7.6 Do the bankruptcy, reorganisation or similar laws in your jurisdiction provide for any kind of moratorium on enforcement of lender claims? If so, does the moratorium apply to the enforcement of collateral security?

After filing for insolvency, but before opening actual insolvency proceedings the court may prohibit enforcement measures against the debtor (except for security over real estate).

After the opening of insolvency proceedings, individual enforcement measures are prohibited. However, a secured creditor generally has a right to preferential treatment, which must be asserted against the insolvency administrator. However, certain forms of security can only be enforced by the insolvency administrator (e.g., movables in the possession of the insolvency administrator, receivables).

7.7 Will the courts in your jurisdiction recognise and enforce an arbitral award given against the company without re-examination of the merits?

According to section 1061 of the German Code of Civil Procedure (*ZPO*), the recognition and enforcement of foreign arbitral awards in Germany is governed by the New York Convention on the Recognition and Enforcement of Foreign Arbitral Awards, dated 10 June 1958. On that basis, foreign arbitral awards will generally be recognised and enforced without re-examination of the merits of the case. Certain exceptions apply, as set out in the New York Convention.

8 Bankruptcy Proceedings

8.1 How does a bankruptcy proceeding in respect of a company affect the ability of a lender to enforce its rights as a secured party over the collateral security?

Security granted by a debtor that falls into bankruptcy may be affected by the debtor's insolvency. In insolvency proceedings over the assets of a debtor, secured creditors will be satisfied with priority (*Absonderung*). Unsecured creditors will be satisfied on a *pro rata* basis from the remaining assets once the secured creditors have been satisfied. Shareholders of the debtor rank last in the satisfaction chain. Furthermore, the insolvency administrator may challenge certain transactions of the insolvent debtor which occurred during certain periods prior to the insolvency and which impair the position of other creditors.

Security granted by third parties is generally not affected by an insolvency of the principal debtor.

8.2 Are there any preference periods, clawback rights or other preferential creditors' rights (e.g., tax debts, employees' claims) with respect to the security?

The insolvency administrator may challenge certain transactions of the insolvent debtor which occurred during certain clawback periods prior to the opening of insolvency proceedings. Relevant clawback periods vary from one month to 10 years prior to the insolvency proceedings and depend on the nature of the relevant legal action (e.g. 10 years in case the action was taken with intent to the detriment of other creditors).

With regard to tax debts, differentiation has to be made whether the relevant tax triggering event has occurred prior to the opening of insolvency proceedings (in which case no preferential payment of such debt will be made) or whether such event occurred after the opening of insolvency proceedings, e.g. by an action taken by the insolvency administrator (in which case such debt has to be satisfied with priority from the insolvency estate).

The same applies, in principle, to employee's claims: claims which result from periods prior to the opening of insolvency proceedings will be treated as non-priority insolvency claims, whereas claims which result from the continuation of the employment relationship after the opening of insolvency proceedings will be satisfied with priority. In addition, employees of the insolvent debtor may be entitled to insolvency payments (*Insolvenzgeld*) to be paid by the Employment Agency on non-satisfied employment claims for a period up to three months prior to the opening of insolvency proceedings.

8.3 Are there any entities that are excluded from bankruptcy proceedings and, if so, what is the applicable legislation?

Under German law, certain public entities (e.g. the federal states, municipalities) are excluded from insolvency proceedings. Furthermore, financial institutions are subject to special rules for insolvency and winding-up proceedings under European law.

8.4 Are there any processes other than court proceedings that are available to a creditor to seize the assets of a company in an enforcement?

With regard to the collection of receivables, creditors may engage debt collection agencies (*Inkassounternehmen*) which need to be registered under the German Legal Services Act (*cf*. the answer to question 7.4 above). Apart from that, creditors usually rely on court proceedings to seize the assets of a company in an enforcement. Private seizure measures are generally not permitted. Further, agreements entered into prior to an event which entitles a pledgee to enforcement and according to which the pledgee shall automatically become an owner of the pledged asset if his claim is not fulfilled in time, are null and void (*cf*. section 1229 of the German Civil Code (BGB)).

9 Jurisdiction and Waiver of Immunity

9.1 Is a party's submission to a foreign jurisdiction legally binding and enforceable under the laws of your jurisdiction?

According to article 25 of regulation (EU) no 1215/2012 on jurisdiction and recognition and enforcement of judgments in civil and commercial matters, a court shall have jurisdiction if the parties contractually agreed on the jurisdiction of such court. Certain requirements (e.g. an agreement in writing or evidenced in writing, no exclusive jurisdiction of another court) need to be fulfilled.

9.2 Is a party's waiver of sovereign immunity legally binding and enforceable under the laws of your jurisdiction?

Sovereign immunity may become relevant in legal transactions involving states or state property. Enforcement regarding assets which serve a sovereign purpose is prohibited. However, a waiver of sovereign immunity is possible. To avoid conflicts, such waiver should be made in explicit (written) form.

10 Licensing

10.1 What are the licensing and other eligibility requirements in your jurisdiction for lenders to a company in your jurisdiction, if any? Are these licensing and eligibility requirements different for a "foreign" lender (i.e. a lender that is not located in your jurisdiction)? In connection with any such requirements, is a distinction made under the laws of your jurisdiction between a lender that is a bank *versus* a lender that is a non-bank? If there are such requirements in your jurisdiction, what are the consequences for a lender that has not satisfied such requirements but has nonetheless made a loan to a company in your jurisdiction? What are the licensing and other eligibility requirements in your jurisdiction for an agent under a syndicated facility for lenders to a company in your jurisdiction?

The German Banking Act (*KWG*) provides that the extension of loans in a commercial manner, or to an extent that requires a commercially organised business, requires a banking licence issued by the German Federal Financial Supervisory Authority (*BaFin*) or a corresponding licence issued by the responsible authority of another EEA Member State. The requirements are the same for German and foreign lenders if the loans are granted in Germany. No distinction is made between banks and non-banks if the extension of loans is made in the aforementioned manner.

Non-compliance with the licensing requirements is a criminal offence under German law and may, in addition, be sanctioned by fines.

No specific licensing or other eligibility requirements apply to an agent under a syndicated facility. However, in case the agent also acts as lender under the facility agreement, the aforementioned licensing requirements apply.

11 Other Matters

11.1 Are there any other material considerations which should be taken into account by lenders when participating in financings in your jurisdiction?

Some particularities under German law become particularly relevant in restructuring situations. Thus, in case fresh money shall be granted in the crisis of a company (by way of a bridge loan (*Überbrückungskredit*) or a restructuring loan (*Sanierungskredit*)), certain requirements have to be met in order to avoid the lender being held liable for delaying insolvency proceedings of the company. Further, a lender (or its managers) who has significant influence on the business decisions of the borrower in the crisis of the borrower might qualify as *de facto* managing director of the borrower and incur liability in this regard. Details with regard to the granting of loans in the crisis of the company as well as with regard to the concept of a *de facto* managing director are not always clear and consistent, so that legal advice should be searched when it comes to such a situation. Finally, shareholders should be aware of the fact that shareholder loans are subordinated to all other claims of creditors of the borrower in insolvency proceedings of the borrower as a matter of statutory law.

Another particularity under German law and a unique type of borrowing used in the German market is a *Schuldscheindarlehen*. In such case, the loan is traded in the form of a promissory note setting out the terms and conditions of the debt. A *Schuldscheindarlehen* might be advantageous for the borrower as it can enlarge the number of possible lenders and result in better conditions for the borrower.

Finally, in particular in cross-border transactions, the German and European sanctions regime needs to be observed, including German and European anti-blocking rules regarding foreign sanctions.

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Dietrich Stiller advises enterprises, sponsors, project companies and banks in a wide range of finance transactions. Alongside conventional corporate finance this also includes project finance, e.g. in the areas of renewable energies, conventional power plants, pipelines or airports, other transport infrastructure, telecommunication or industrial facilities. Many of those finance transactions are transnational and involve ECA or other guarantees of the German federal government, foreign export credit agencies (ECAs) or multinational institutions – also taking into account German and international sanctions. Legal advice in relationship to international projects furthermore includes the prevention of events of loss, or the mitigation of events of loss as well as legal support in case of actual or imminent expropriations, including legal advice in related arbitration proceedings.

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SZA

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For almost a century, Schilling, Zutt & Anschütz has been one of the most reputable German law firms. We advise domestic and international clients in all areas of corporate and commercial law with currently 80 attorneys. Over the last few years, our clients have included 14 of the 30 enterprises listed on the DAX. We are legal counsel for leading industrial and trade enterprises, banks, insurance companies and financial services providers as well as large family-owned businesses and wealthy private clients.

In addition to issues dealing with general finance, bank and bank supervisory law, we advise our clients in all matters concerning financing transactions such as (tax-optimised) structuring of financing and financing instruments, including corresponding capital market products. We draft, negotiate and finalise the necessary financing and security agreements and comprehensively guide our clients in implementing and carrying out their financing and projects. Our expertise in financial law further comprises advice on work-outs/restructuring. We are well aware of what it takes in a company crisis.

Greece

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1 Overview

1.1 What are the main trends/significant developments in the lending markets in your jurisdiction?

In 2018, the lending market in Greece grew compared to the previous year. The real estate sector continues to develop at a fast pace and Greek banks are investing in real estate projects being developed by real estate investment companies ("REIC"). Furthermore, it should be noted that on June 2018, Law 4548/2018 was voted for by the Hellenic Parliament, replacing and introducing an overall reform to the legal framework on *société anonymes* (the "Company Law"). In terms of bond loans, which are broadly used in Greek lending markets, the Company Law now incorporates the majority of the relevant provisions of the previous legislative framework. In addition, the Company Law adopts a number of innovative rules, which have been applied extensively in international practice, in order to encourage and facilitate corporate financing, while aligning with the international market standards. The Company Law came into force on January 1, 2019 (subject to particular exceptions).

1.2 What are some significant lending transactions that have taken place in your jurisdiction in recent years?

During the last months of 2018, Athens International Airport issued a bond loan of approximately €660m, subscribed by a private placement of Greek banks. The financing will be used to expand the Athens International Airport, according to the terms of the relevant concession agreement between the Greek state and the Athens International Airport. Athens International Airport is a very important project for the Greek economy as a pillar of tourism and business development. Completion of the funded extension of the 20-year concession period marks the confidence in the long-term investment prospects of the country.

2 Guarantees

2.1 Can a company guarantee borrowings of one or more other members of its corporate group (see below for questions relating to fraudulent transfer/financial assistance)?

The new rules of the Company Law concerning related-party transactions (including guarantees and security) provide that, in general, contracts between a company and its related parties are prohibited as invalid and no security or guarantee may be granted to any third parties or the benefit of said related parties without the previous consent of the Board of Directors or the General Assembly (GA). However, the new Company Law provides for exceptions from the abovementioned prohibitions in certain cases, and lays down the procedure for the consent of the Board of Directors or the GA required for the said related-party transaction (for example, parent companies may guarantee the borrowings of one or more 100% subsidiaries or/and any subsidiary whose shareholder structure does not include any related party). It should be noted that the conditions for the grant of consent for the related-party transactions depend on whether the company is listed on regulated markets or not (for example, in the case of listed companies, the consent is provided on the basis of a fairness opinion by an auditor). Finally, transactions entered into in the ordinary course of business and concluded on normal market terms fall outside the scope of the above restrictions.

2.2 Are there enforceability or other concerns (such as director liability) if only a disproportionately small (or no) benefit to the guaranteeing/securing company can be shown?

As a general rule, corporate guarantees must serve the corporate purpose of the corporate guarantor. In case such condition is not met, the guarantee may be invalid and directors' liability may arise.

2.3 Is lack of corporate power an issue?

Lack of corporate power may arise only in respect of the service of the corporate purpose of the corporate guarantor.

2.4 Are any governmental or other consents or filings, or other formalities (such as shareholder approval), required?

In case of guarantees between companies which are not subject to exceptions (see question 2.1), according to the Company Law, the following procedure must take place: the Board of Directors must decide, by giving its authorisation, if such a transaction will take place. Such decision must be recorded in the General Commercial Registry. In the 10 days between the publication of the Board of Directors' resolution (which grants permission for the transaction – if that is the case) and the final validity of the transaction, shareholders representing one 1/20 of the capital may request the convocation of a General Assembly to decide on the issue of authorisation. The Articles of Association may reduce this rate to 1% of the capital.

2.5 Are net worth, solvency or similar limitations imposed on the amount of a guarantee?

There are no such limitations.

2.6 Are there any exchange control or similar obstacles to enforcement of a guarantee?

In general, no.

3 Collateral Security

3.1 What types of collateral are available to secure lending obligations?

Under Greek law, lending obligations are secured by securities *in personam* and/or by securities *in rem*. Securities *in personam* are mainly guarantees and securities *in rem* are mortgages (or prenotation of mortgages) and pledge over assets, rights and claims. Legislative decree of 17 July 1923 on pledge over claims, in favour of credit institutions, provides that such pledge also gives entitlement to assignment for the collection of such claims. It should be noted that, in practice, most term loan facilities to Greek companies (in the form of *société anonymes*) are structured as bond loans, i.e. through the issuance of debt securities subscribed by private placement. This is because the legal framework for bonds provides for cost and tax exemptions (see our answer to question 3.9 below).

3.2 Is it possible to give asset security by means of a general security agreement or is an agreement required in relation to each type of asset? Briefly, what is the procedure?

Asset security by means of a general security agreement is possible. Nevertheless, since each type of asset and each type of security is perfected by different procedures and registration requirements, a separate agreement is commonly used. As far as the procedure is concerned, see our answers below regarding different types of assets and different types of security.

3.3 Can collateral security be taken over real property (land), plant, machinery and equipment? Briefly, what is the procedure?

Security over real property (land) and plant is created by mortgage (by virtue of a notarial mortgage deed) or by mortgage prenotation (by virtue of a county court decision) and perfected by registration in the public books of the competent land registry or cadastre where the land and plant are located. Prenotation of mortgage provides its beneficiary with the preemptive right to obtain a mortgage perfected as of the date of registration of the prenotation of mortgage, once its claim becomes final. Such security extends to all component parts and accessories of the real estate (i.e. machinery and equipment).

As far as machinery and equipment are concerned, security can be created by a non-possessory pledge agreement by virtue of article 1 of Law no. 2844/2000 and perfected by registration in the public book of Law no. 2844/2000 kept by the competent public registry where the borrower has its corporate seat.

3.4 Can collateral security be taken over receivables? Briefly, what is the procedure? Are debtors required to be notified of the security?

Security over receivables (trade receivables and insurance proceeds) is created by a private agreement and perfected by notification to the debtor of the relevant claims. In banking practice, such security is granted in the form of pledge and assignment of the receivables due to such pledge, by virtue of legislative decree of 17 July 1923. Security over business receivables may also be granted under articles 11–15 of Law no. 2844/2000 and perfected by registration in the public book of Law no. 2844/2000 kept by the competent public registry where the borrower has its corporate seat (in addition to notification of the debtor).

Security may extend to future receivables, provided that they are specifically defined in the security agreement and fall within the scope of the pledge.

3.5 Can collateral security be taken over cash deposited in bank accounts? Briefly, what is the procedure?

Collateral security over cash deposited in bank accounts is created by a private agreement and perfected by notification to the bank holding such accounts. Standard practice provides for such collateral in cash to be governed by the legislative decree of 17 July 1923 and/or Law no. 3301/2004 on financial collateral agreements.

3.6 Can collateral security be taken over shares in companies incorporated in your jurisdiction? Are the shares in certificated form? Can such security validly be granted under a New York or English law-governed document? Briefly, what is the procedure?

Unless otherwise provided by the Articles of Association of the company incorporated under Greek law, collateral security (pledge) over the company's shares is created by a private agreement and perfected by physical delivery of the shares to the pledgee or a third-party custodian.

It should further be noted that according to the new provisions of the Company Law, Greek companies can no longer issue bearer shares. Bearer shares that have been already issued by Greek companies must be converted to registered ones by 1 January 2020.

Security over shares listed on the Athens Stock Exchange is created by private agreement and perfected by notification and registration to the Dematerialised Securities System, pursuant to the regulation of the Hellenic Central Securities Depositary.

Security may extend to new shares issued by the company and dividends or other benefits, such as voting rights, but not to preference rights of the shareholders, since such rights do not exist at the time the security agreement is perfected (under Greek law, preference rights of the shareholders are considered as rights of expectation and are created when the General Assembly decides on a share capital increase).

The law governing the pledge over shares issued by Greek companies is subject to the rule of *lex rei sitae*; i.e. the law of the place where the property is situated. Therefore, such security may only be governed by Greek law.

3.7 Can security be taken over inventory? Briefly, what is the procedure?

Security over inventory is governed by articles 16–18 of Law no. 2844/2000 (floating charge over inventory) and created by a private agreement. In order for such security to be perfected, the private agreement must be registered in the public book of Law no. 2844/2000 kept by the competent public registry where the borrower has its corporate seat.

3.8 Can a company grant a security interest in order to secure its obligations (i) as a borrower under a credit facility, and (ii) as a guarantor of the obligations of other borrowers and/or guarantors of obligations under a credit facility (see below for questions relating to the giving of guarantees and financial assistance)?

A company may grant security to secure its obligations both as a borrower under a credit facility and as a guarantor of the obligations of other borrowers and/or guarantors of obligations. We also refer to our answers to section 2 above regarding intragroup company guarantees.

3.9 What are the notarisation, registration, stamp duty and other fees (whether related to property value or otherwise) in relation to security over different types of assets?

Mortgages, prenotation of mortgages, non-possessory pledges and floating charges are subject to registration in the public books of the competent land registry and/or cadastre. Registration fees for the land registry amount to 0.775% of the secured amount. Registration fees for the cadastre amount to 0.875% of the secured amount.

In case of mortgages, notarial fees range from 0.2% to 1% of the secured amount. In case of prenotation of mortgages, court fees do not exceed €300.

Under the legal framework for bond loans, registration fees are fixed at €100 per registration, which minimises the costs of security granted under bonds loans.

3.10 Do the filing, notification or registration requirements in relation to security over different types of assets involve a significant amount of time or expense?

The filing, notification and registration process usually does not involve a significant amount of time in order for it to be completed. However, the time needed may vary depending on the efficiency of the competent authority/registry office in each individual case. As for the expenses, please refer to question 3.9 above.

3.11 Are any regulatory or similar consents required with respect to the creation of security?

In principle, no consents are required.

3.12 If the borrowings to be secured are under a revolving credit facility, are there any special priority or other concerns?

No. Revolving credit facilities are secured by the same means and procedure described herein in section 3.

3.13 Are there particular documentary or execution requirements (notarisation, execution under power of attorney, counterparts, deeds)?

Please refer to our answers above.

4 Financial Assistance

4.1 Are there prohibitions or restrictions on the ability of a company to guarantee and/or give security to support borrowings incurred to finance or refinance the direct or indirect acquisition of: (a) shares of the company; (b) shares of any company which directly or indirectly owns shares in the company; or (c) shares in a sister subsidiary?

(a) Shares of the company

Under applicable law, that is, pursuant to the relevant provisions of article 51 of the Company Law, a company (other than a credit institution) is prohibited from making down payments, providing guarantees and/or loans to support borrowings incurred to finance the direct or indirect acquisition of its shares by third parties, unless the following conditions are met:

1. The aforementioned transactions are carried out under the responsibility of the Board of Directors of the company within the market standards, in particular with respect to the interest received by the company and the guarantees it receives to secure its claims. Proper due diligence must be conducted regarding the solvency of the third party or, in the case of multilateral transactions, of each counterparty.
2. The General Assembly of the shareholders of the company provides its prior consent by an increased quorum and majority. It is noted that the Board of Directors submits to the GA a written report setting out the reasons which, in light of the company's best interests, justify the said transaction, its terms (including the price at which the third party will acquire the shares) as well as the risks that the contemplated transaction may pose to the liquidity and solvency of the company and the price. Please note that, in case the members of the Board of Directors of the issuing or the parent company are directly or indirectly contracting parties to the respective transactions, an auditor's report must also be submitted to the GA.
3. The total financial assistance provided to third parties (or the total secured amount), which shall appear in the balance sheet as a non-distributable reserve, does not result in a reduction of the company's own funds to an amount lower than the aggregate amount of share capital and non-distributable reserves.

(b) Shares of any company which directly or indirectly owns shares in the company

Pursuant to the provisions of the same article 51 of the Company Law, the restrictions mentioned under (a) above also apply to down payments, guarantees and/or loans provided by subsidiaries for the acquisition of the parent company's shares by third parties.

(c) Shares in a sister subsidiary

The Company Law does not include provisions regulating the case in question.

5 Syndicated Lending/Agency/Trustee/Transfers

5.1 Will your jurisdiction recognise the role of an agent or trustee and allow the agent or trustee (rather than each lender acting separately) to enforce the loan documentation and collateral security and to apply the proceeds from the collateral to the claims of all the lenders?

The role of the agent/trustee is provided by the bond loan legal framework, under which any security granted by the borrower is granted in the name of the bondholders' agent, for the benefit of the bondholders. The bondholders' agent is responsible for enforcing loan documentation and collateral securities and applying the proceeds from the collateral to the claims of all the lenders *pro rata*, unless otherwise agreed.

Furthermore, article 73 § 3 of the Company Law provides that in case a bond loan is governed by foreign law, collateral security and guarantees are granted in the name of the person who, under the law governing the bond loan, may hold securities and guarantees on his/her account on behalf of the bondholders. The registration shall be made in the name of the agent, with explicit indication that the guarantee is granted to secure debts from a bond loan.

5.2 If an agent or trustee is not recognised in your jurisdiction, is an alternative mechanism available to achieve the effect referred to above which would allow one party to enforce claims on behalf of all the lenders so that individual lenders do not need to enforce their security separately?

Since Greek law only recognises the notion of bondholders' agent, an alternative mechanism to achieve such an effect is a contractual agreement between the lenders of a syndicated credit facility (intercreditors' agreement) providing that the collateral security is granted in the name of the security trustee, who is also a joint and several creditor with the other secured lenders. However, lenders are not protected in case of insolvency proceedings of the security agent.

5.3 Assume a loan is made to a company organised under the laws of your jurisdiction and guaranteed by a guarantor organised under the laws of your jurisdiction. If such loan is transferred by Lender A to Lender B, are there any special requirements necessary to make the loan and guarantee enforceable by Lender B?

The transfer of a loan from the initial lender to a successor lender or, to be more precise, the transfer of the relevant rights and obligations, is legally permitted in principle, subject to the specific provisions of each individual loan agreement. The procedure of such transfer of rights and obligations is regulated by the relevant provisions of the Greek Civil Code and is considered to be perfected, on the condition that the debtor and/or the guarantor is notified of the said transfer.

6 Withholding, Stamp and Other Taxes; Notarial and Other Costs

6.1 Are there any requirements to deduct or withhold tax from (a) interest payable on loans made to domestic or foreign lenders, or (b) the proceeds of a claim under a guarantee or the proceeds of enforcing security?

The current tax rate for tax withholding on interest from bond loans is 15%. Notably, interest payable on credit facilities concerning either domestic or foreign lenders is not subject to withholding tax. As for foreign lenders in particular, please refer to question 6.2 below.

6.2 What tax incentives or other incentives are provided preferentially to foreign lenders? What taxes apply to foreign lenders with respect to their loans, mortgages or other security documents, either for the purposes of effectiveness or registration?

Interest payments to lenders that are tax-resident outside of Greece and without a permanent establishment in Greece are subject to Greek withholding tax, currently at the rate of 15%, if not otherwise provided for in the tax treaty (if any) between Greece and the jurisdiction of tax-residence of the foreign lender.

6.3 Will any income of a foreign lender become taxable in your jurisdiction solely because of a loan to, or guarantee and/or grant of, security from a company in your jurisdiction?

No income of a foreign lender becomes taxable in Greece solely because of a loan to or guarantee and/or grant of security from a company in Greece.

6.4 Will there be any other significant costs which would be incurred by foreign lenders in the grant of such loan/guarantee/security, such as notarial fees, etc.?

An annual contribution of 0.6% is imposed on the average outstanding monthly balance of each loan granted by a bank to a Greek resident. Loans between banks, loans to the Greek State and loans funded by the European Investment Bank or by the European Bank for Reconstruction and Development are exempt from said contribution. As far as guarantees are concerned, there are no additional costs and fees. As for securities, please refer to question 3.9 above.

6.5 Are there any adverse consequences for a company that is a borrower (such as under thin capitalisation principles) if some or all of the lenders are organised under the laws of a jurisdiction other than your own? Please disregard withholding tax concerns for purposes of this question.

In case some or all of the lenders are organised under the laws of a jurisdiction other than Greece, there are no particular adverse effects for the borrower stemming from such a fact.

7 Judicial Enforcement

7.1 Will the courts in your jurisdiction recognise a governing law in a contract that is the law of another jurisdiction (a "foreign governing law")? Will courts in your jurisdiction enforce a contract that has a foreign governing law?

Under applicable law, that is, pursuant to the provisions of (a) Regulation EC 593/2008 "on the law applicable to contractual obligations (Rome I)" (which replaced the 1980 Rome Convention on the law applicable to contractual obligations, except as regards the territories of the Member States which fall within the territorial scope of that Convention and to which this Regulation does not apply pursuant to Article 299 of the Treaty), (b) the 1980 Rome Convention (to the extent that it was not replaced by Regulation EC 593/2008), and (c) the relevant articles of the Greek Civil Code (in the cases where (a) and (b) above do not apply), it can be concluded that, in principle, the parties to a contract are free to choose the law that shall govern their contract. However, there are certain limitations on this freedom of choice, concerning overriding mandatory provisions (i.e. provisions, the respect for which is regarded as crucial by the Hellenic Republic for safeguarding its public interests, such as its political, social or economic organisation, to such an extent that they are applicable to any situation falling within their scope, irrespective of the law otherwise applicable to the contract) as well as the Greek public order. Therefore, it can be concluded that, subject to the aforementioned limitations, Greek courts do recognise and enforce contracts that are subject to foreign governing law.

7.2 Will the courts in your jurisdiction recognise and enforce a judgment given against a company in New York courts or English courts (a "foreign judgment") without re-examination of the merits of the case?

Under applicable law, that is, pursuant to the provisions of (a) the relevant EU Regulations (e.g. Regulation EU 1215/2012 "on jurisdiction and the recognition and enforcement of judgments in civil and commercial matters" and Regulation EC 805/2004 "creating a European Enforcement Order for uncontested claims"), (b) bilateral international conventions, and (c) the relevant articles of the Greek Code of Civil Procedure, whichever applies in each case, it can be concluded that although in principle Greek courts will recognise and enforce a foreign judgment without re-examination of the case, such recognition and enforcement may be denied if any of the following applies: (a) the foreign judgment is not an enforceable title or *res judicata* according to the law of the foreign country where the judgment was issued; (b) it is issued by a foreign court not having jurisdiction as per Greek law; (c) the defendant was deprived of its right to a fair trial; (d) the foreign judgment is irreconcilable with an earlier Greek judgment, which is *res judicata* and involves the same cause of action between the same parties; or (e) it violates Greek public order.

7.3 Assuming a company is in payment default under a loan agreement or a guarantee agreement and has no legal defence to payment, approximately how long would it take for a foreign lender to (a) assuming the answer to question 7.1 is yes, file a suit against the company in a court in your jurisdiction, obtain a judgment, and enforce the judgment against the assets of the company, and (b) assuming the answer to question 7.2 is yes, enforce a foreign judgment in a court in your jurisdiction against the assets of the company?

Pursuant to the provisions of Law no. 4335/2015, which entered into force on 1 January 2016 and constituted a significant reform of the Greek Code of Civil Procedure, particularly aiming to accelerate the dispensation of justice, strict timeframes were set regarding the procedural stages from filing a law suit in a Greek court to the issuance of a judgment of first degree (i.e. appealable, that is, not yet *res judicata*), resulting in shortening the aggregate time needed for the completion of the said judicial proceedings. In view of the above, as of now it is estimated that, in case of a law suit filed by a foreign lender in a Greek court and based on a contract governed by the Greek law, it might take on average from 12 to 16 months for a judgment of first degree to be issued, whereas, in case of a payment order, this timeframe is reduced to approximately six months. It should be noted that, in the case of contracts governed by foreign law, the aforementioned timeframes are expected to be significantly longer.

As far as the enforcement of a judgment (either Greek or foreign) is concerned, it should be noted that the reform of the Greek Code of Civil Procedure introduced the notion of electronic auctions. As from 21 February 2018, all enforcement auctions are conducted solely via the electronic platform which is managed by the competent Greek Notaries Association. According to the provisions of the Greek Code of Civil Procedure, electronic auctions take place no later than seven months after the day of termination of the asset seizure.

It should also be noted that, in the case of a foreign judgment, the period required for its recognition by the Greek court may prove to be considerable.

7.4 With respect to enforcing collateral security, are there any significant restrictions which may impact the timing and value of enforcement, such as (a) a requirement for a public auction, or (b) regulatory consents?

Under applicable law, that is, pursuant to the provisions of the relevant articles of the Greek Code of Civil Procedure, the individual stages of the enforcement procedure are described in detail and specific timeframes are set, within which enforcement proceedings shall be effectuated. As a general rule, in order for the enforcement procedure to commence, the creditor-beneficiary of the collateral security (i.e. the mortgagee/pledgee of mortgaged/pledged immovable/movable assets) must obtain an enforceable title (i.e. mainly non-appealable judgments, arbitral awards, payment orders, notarial deeds, etc.). Subsequently, as far as pecuniary claims are concerned, the enforcement procedure involves the following main stages: (a) the attachment of the debtor's assets; (b) the intervention of other creditors; (c) the liquidation of the attached assets through public electronic auction; and (d) the distribution of proceeds. In particular, regarding the liquidation process, it is noted that liquidation is effected by electronic auction, which is administered by a notary public who is certified to conduct electronic auctions (we also refer to our answer to question 7.3. above).

As to the distribution of proceeds from the public electronic auction of a specific asset, it is noted that, in principle, the proceeds are distributed to all the creditors who participated in the liquidation process. In case the electronic auction proceeds, after deducting the costs and expenses of the enforcement proceedings, are less than the total claims of the creditors, who participated in the respective proceedings, then they are proportionally distributed. However, certain categories of creditors have priority over the proportional distribution as follows: (a) claims provided with a general privilege (i.e. claims of the State and of other public entities, claims for wages and personal maintenance, etc.) have a minimum priority of 25% of the total proceeds; (b) claims provided with a special privilege, that is, secured claims (i.e. collateral security on the specific asset on which enforcement takes place) as well as claims regarding the maintenance of the property and the production and harvest of its fruits, have a minimum priority of 65% of the total proceeds; and (c) unsecured claims have a minimum priority of 10% of the total proceeds.

It should be noted that the legislative decree of 17 July 1923 introduces an exception to the aforementioned rule, according to which the liquidation of the attached assets is effectuated through public electronic auction. More specifically, the legal effect of a pledge of claims under the provisions of the legislative decree of 17 July 1923 is that the pledgee-credit institution arguably acquires full ownership of the claim and is entitled to liquidate the claim, with the obligation to return to the pledgor-debtor any amount exceeding the secured claim.

Another exception to the above rule is introduced by Law no. 3301/2004 on financial collateral agreements, under which provisions the satisfaction of the pledgee-creditor is effectuated through sale, set-off or application of the financial instruments and/or cash in discharge of the relevant obligations.

No regulatory consents are required.

7.5 Do restrictions apply to foreign lenders in the event of (a) filing suit against a company in your jurisdiction, or (b) foreclosure on collateral security?

No restrictions apply. However, it has been argued that foreign lenders do not enjoy the benefits of the legislative decree of 17 July 1923.

7.6 Do the bankruptcy, reorganisation or similar laws in your jurisdiction provide for any kind of moratorium on enforcement of lender claims? If so, does the moratorium apply to the enforcement of collateral security?

Pursuant to the provisions of Law no. 3588/2007 (i.e. the Greek Bankruptcy Code), in the case of declaration of bankruptcy, a suspension of all individual enforcement actions is imposed on all unsecured creditors and/or all priority creditors (i.e. creditors whose claims have a general privilege for satisfaction from the whole of the debtor's estate). As for the secured creditors (i.e. creditors whose claims are secured by special privilege or real security on a specific asset of the debtor's estate), they may undertake enforcement action against the specific secured asset, unless such secured assets are functionally and directly linked to the debtor's business. The aforementioned moratorium may last up to 10 months, starting from the issuing date of the court decision which declares the bankruptcy. As far as pre-insolvency proceedings are concerned, under the relevant provisions of the Greek Bankruptcy Code, which provide for the conclusion of an agreement between the debtor and a certain percentage of its creditors (60% of the total claims including 40% of secured claims) (hereinafter referred to as the "Rehabilitation Agreement") and the subsequent ratification from the Court of such agreement, from the filing of the Rehabilitation Agreement for ratification until the issuance of the decision of the Court, all individual and collective enforcement action is automatically suspended. This moratorium may not normally exceed four months and may be extended, following application, for as long as the decision for ratification remains pending. It is also noted that the Rehabilitation Agreement may include more specific provisions concerning such moratorium. However, it should be mentioned that agreements on financial collateral under Law no. 3301/2004 do not fall under the scope of any kind of moratorium on enforcement in the abovementioned cases; namely in case of declaration of bankruptcy and pre-insolvency proceedings, etc.

7.7 Will the courts in your jurisdiction recognise and enforce an arbitral award given against the company without re-examination of the merits?

Under applicable law, that is, pursuant to the provisions of (a) the 1958 New York Convention on the Recognition and Enforcement of Foreign Arbitral Awards, and (b) the relevant articles of the Greek Code of Civil Procedure, whichever applies in each case, it can be concluded that, in principle, Greek courts will recognise and enforce an arbitral award without re-examination of the case, subject to certain limitations, including, e.g., that the award has become binding on the parties, that it does not violate Greek public order, that the party against whom the award is invoked was able to present his case before the appointed arbitral authority, etc.

8 Bankruptcy Proceedings

8.1 How does a bankruptcy proceeding in respect of a company affect the ability of a lender to enforce its rights as a secured party over the collateral security?

As mentioned above under question 7.6, pursuant to the relevant provisions of the Greek Bankruptcy Code, in the case of declaration of bankruptcy, a moratorium on individual enforcement action is imposed on all unsecured creditors and/or all priority creditors, whereas the secured creditors (i.e. creditors whose claims are secured by special privilege or real security on a specific asset of the debtor's estate) may pursue their satisfaction solely by the liquidation of the specific secured asset, unless they waive their special privilege/security or such privilege/security proves to be insufficient for their complete satisfaction, in which case they are satisfied by the whole bankruptcy estate.

Moreover, please note that the Greek Bankruptcy Code provides that transactions carried out during the so-called "suspect period" (i.e. the period specified in the court decision declaring the bankruptcy, which may not precede the date of issuance of the said decision by more than two years and during which it is assumed that the bankrupt debtor has discontinued its payments), including transactions concerning the establishment of *in rem* securities (including the pre-notation of mortgage) or provision of guarantees for pre-existing obligations, are subject to clawback, upon request of the bankruptcy administrator or a creditor, and thus rescinded and made null and void. It should also be noted that security agreements established by virtue of the provisions of Law no. 3301/2004 on financial collateral agreements are, in principle, not subject to the clawback provisions of the Greek Bankruptcy Code and generally remain unaffected by bankruptcy proceedings. The same holds true for the security agreements which were carried out pursuant to the provisions of the Rehabilitation Agreement, which is mentioned above under question 7.6.

8.2 Are there any preference periods, clawback rights or other preferential creditors' rights (e.g., tax debts, employees' claims) with respect to the security?

As mentioned above under question 8.1, pursuant to the relevant provisions of the Greek Bankruptcy Code, certain types of transactions, that is (a) donations or other transactions in which the consideration received by the bankrupt person or entity from its counterparty are disproportionately small in relation to its own obligations, (b) payments of non-outstanding debt, (c) non-cash payments of outstanding debts, or (d) establishment of *in rem* securities (including the pre-notation of mortgage) or provision of guarantees, for pre-existing obligations, if carried out during the "suspect period", are subject to clawback, upon request of the bankruptcy administrator or a creditor. Please note that the legal consequences of the clawback are that the transactions in question are null and void and are rescinded. Further, transactions involving the bankrupt debtor and entered into during a period of five years preceding the declaration of bankruptcy are subject to clawback if the bankrupt person has acted intentionally to damage its creditors or discriminate against some of them and the counterparty was aware of the bankrupt person's intention.

As far as the procedure regarding the liquidation of the bankrupt debtor's estate is concerned, it is noted that the liquidation proceeds in the context of the bankruptcy proceedings are distributed in accordance with the relevant provisions of the GCCP, which regulate the liquidation process in the context of the enforcement proceedings in general, and also the same system of privileges applies (for a detailed analysis regarding the distribution of proceeds under the provisions of GCCP, please refer to question 7.4).

8.3 Are there any entities that are excluded from bankruptcy proceedings and, if so, what is the applicable legislation?

Under applicable law, that is, pursuant to the relevant provisions of the Greek Bankruptcy Code, merchants (either individuals or legal entities) as well as associations with legal personality that pursue economic purposes are subject to bankruptcy proceedings. Legal entities governed by public law, public authorities in general as well as local authorities are not subject to bankruptcy proceedings and cannot be declared bankrupt.

Please also note that there are separate laws providing and regulating a special liquidation process for certain categories of legal entities, that is: (a) Law no. 4261/2014 regarding credit institutions; (b) Law no. 4514/2018 regarding investment firms; and (c) Law no. 4364/2016 regarding insurance undertakings.

8.4 Are there any processes other than court proceedings that are available to a creditor to seize the assets of a company in an enforcement?

Please refer to question 7.4 above, where it is noted that, through the processes provided for by legislative decree of 17 July 1923, as well as by Law no. 3301/2004, the secured creditor/pledgee may satisfy the secured claims without having to necessarily resort to court proceedings and subsequently to the liquidation of the debtor's assets through public electronic auction.

9 Jurisdiction and Waiver of Immunity

9.1 Is a party's submission to a foreign jurisdiction legally binding and enforceable under the laws of your jurisdiction?

Yes, a party's submission to a foreign jurisdiction is legally binding and enforceable under Greek law.

9.2 Is a party's waiver of sovereign immunity legally binding and enforceable under the laws of your jurisdiction?

Where no prevailing mandatory provisions apply, by virtue of which the right to sovereign immunity is under all circumstances and without exception awarded and/or recognised, a party's waiver of sovereign immunity is, in principle, legally binding and enforceable under Greek law.

10 Licensing

10.1 What are the licensing and other eligibility requirements in your jurisdiction for lenders to a company in your jurisdiction, if any? Are these licensing and eligibility requirements different for a "foreign" lender (i.e. a lender that is not located in your jurisdiction)? In connection with any such requirements, is a distinction made under the laws of your jurisdiction between a lender that is a bank *versus* a lender that is a non-bank? If there are such requirements in your jurisdiction, what are the consequences for a lender that has not satisfied such requirements but has nonetheless made a loan to a company in your jurisdiction? What are the licensing and other eligibility requirements in your jurisdiction for an agent under a syndicated facility for lenders to a company in your jurisdiction?

The main type of lenders to companies under Greek law are credit institutions, which are regulated by the provisions of Law no. 4261/2014 and are authorised and supervised by the Bank of Greece. There also exist venture capital companies under the provisions of article 5 of Law no. 2367/1995, which have as one of their objects the investment in bonds issued by Greek companies, as well as other licensed companies (e.g. investment firms), which in certain exceptional cases and for limited purposes are legally permitted to grant loans to their clients. Please note that Law no. 4261/2014 provides that, in case of non-EU credit institutions, a special authorisation by the Bank of Greece is required. Apart from the aforementioned lenders, Law no. 4261/2014 also provides that lending is permitted between members of the same corporate group. In addition to the above, please note that, by virtue of Law no. 4354/2015, a new legal framework for the management and transfer of claims from NPLs has been introduced into the Greek market, so as to help credit institutions clean up their balance sheets from non-performing, or so called "red", loans (NPLs). Law no. 4354/2015 has also introduced two new types of company into the Greek legal system, in relation to the management and transfer of claims arising from loans and credits, i.e.: (a) Loans Management Companies (L.M.C.s); and (b) Loans Transfer Companies (L.T.C.s), which may under certain conditions provide new loans to the debtors of such NPLs. As far as the licensing of said companies is concerned, please note that L.M.C.s must be granted a special operating licence by the Bank of Greece for the purpose of the NPLs' management. As for the L.T.C.s, they are not required to obtain any operating licence from the Bank of Greece. However, if the L.T.C.s include loan/credit acquisitions within their scope of activity, they must enter into a loan management agreement with an L.M.C. which is properly licensed and supervised by the Bank of Greece.

Finally, in the case of a lender not appropriately authorised, that nonetheless makes a loan to a company, under Greek law, there are specified provisions for administrative sanctions, including but not limited to pecuniary ones (i.e. fines), which are imposed by the respective supervisory authority.

11 Other Matters

11.1 Are there any other material considerations which should be taken into account by lenders when participating in financings in your jurisdiction?

The lender should bear in mind that, although partially lifted, a broad range of capital controls still remain in place in Greece. Notably though, the capital controls framework is relaxed for inbound transfer of monies – such inbound monies are practically free of restrictions.

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Panagiotis (Notis) is a partner at Sardelas Liarikos Petsa Law Firm and a highly experienced business lawyer with particular expertise in the field of capital markets and banking & finance law for more than 15 years. The capital markets side of his practice involves advising Greek and international financial institutions, IFIs, funds and large corporates, as well as the Greek state and state-owned enterprises, on ECM and DCM transactions and financial operations in Greece and abroad, and compliance with securities regulations. Notable highlights include the first listing of an investment firm in the Greek EN.A., the structuring of the first Eurobond-compatible Greek bond issued under law 3156 and its listing in the Bank of Greece secondary market (HDAT), the first dematerialisation and listing in HDAT of Greek law bonds, the last recapitalisation and LME of a major Greek bank, and the public offer and listing of the first Greek domestic corporate bond issue under the new electronic book-building procedure. In the context of the abovementioned transactions, Notis has also assisted the Greek market operator in shaping the regulatory framework for Greek domestic corporate bond listings. He also has considerable experience in acting in tender offers, mergers & acquisitions and restructurings, especially in the context of privatisations.

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Sardelas Liarikos Petsa Law Firm has established a leading position in Greek legal services as a business law firm with a strong international dimension, and is well known in Greece and abroad for its top drawer specialised professional service in complex cross-border and domestic transactions, as well as commercial litigation. The firm is recognised by international legal directories and is considered by clients and peers alike as a legal practice with high expertise and experience, which comes up with innovative, practical and legally sage solutions in relation to complex transactions, some of which are considered to be innovative not only by Greek but also by international market standards. Its high-quality and innovative brand has been internationally recognised by experts and peers as it is consistently recommended in prestigious legal directories, such as the *IFLR 1000*, *The Legal 500* and *Chambers & Partners*, while in 2009 it has been selected on the IFLR Awards shortlist for the most innovative debt and equity-linked transaction in Europe.

Hong Kong


Richard Mazzochi


Khin Voong

King & Wood Mallesons

1 Overview

1.1 What are the main trends/significant developments in the lending markets in your jurisdiction?

Hong Kong maintained a significant contribution to Asia Pacific's syndicated loan markets in 2018, with lending at US$110.6 billion (compared to US$116.3 billion in 2017) (according to market data provider Refinitiv). Event-driven financings were down generally, not least because of the slowdown in Chinese outbound acquisitions.

Nevertheless, Hong Kong remains the key gateway for offshore financing to Chinese corporates, and for financings related to the Chinese "One Belt One Road" initiative. Hong Kong is expected to maintain this position for the foreseeable future, and as such the market will continue to be affected by changing PRC regulations relating to offshore financings by Chinese corporate groups.

1.2 What are some significant lending transactions that have taken place in your jurisdiction in recent years?

The single biggest regional financing was a US$5.5bn refinancing of the acquisition loan for Syngenta AG, which was arranged by a range of global banks.

2 Guarantees

2.1 Can a company guarantee borrowings of one or more other members of its corporate group (see below for questions relating to fraudulent transfer/financial assistance)?

A company can give a guarantee or grant security over its assets in respect of the borrowings of another member of its corporate group.

2.2 Are there enforceability or other concerns (such as director liability) if only a disproportionately small (or no) benefit to the guaranteeing/securing company can be shown?

A director has a fiduciary duty towards the company and must act in its best interests. This applies when considering the giving of a guarantee or other security. If a director breaches its duty, then it may be personally liable towards the company.

The directors of the company will have to consider whether the giving of the guarantee will be in the best interests of the company and whether the company will benefit from the giving of such guarantee. It is important that the company itself, not only the group as a whole, will derive benefit from the giving of the guarantee. It is generally easier to establish that there is corporate benefit for a guarantor giving a downstream guarantee than a guarantor giving an upstream guarantee or a cross-stream guarantee.

2.3 Is lack of corporate power an issue?

Section 115 of the Companies Ordinance provides that a company has the capacity, rights, powers and privileges of a natural person of full age. If, however, the objects of a company are stated in its articles of association, the company must not do any act that it is not authorised to do by its articles of association. Also, if any power of a company is expressly modified or excluded by its articles of association, the company must not exercise any power contrary to such modification or exclusion.

2.4 Are any governmental or other consents or filings, or other formalities (such as shareholder approval), required?

No governmental approval, consent or registration is required.

In view of the issues raised in question 2.2 above, it is recommended that shareholder resolutions approving the giving of the guarantee are obtained where it secures the obligations of a parent or sister company.

2.5 Are net worth, solvency or similar limitations imposed on the amount of a guarantee?

These matters would not affect any limit on the amount of a guarantee. However, if a company is experiencing solvency issues, the matters referred to in question 8.2 should be borne in mind.

2.6 Are there any exchange control or similar obstacles to enforcement of a guarantee?

No, there are not.

3 Collateral Security

3.1 What types of collateral are available to secure lending obligations?

It is possible to take security over almost any type of asset in Hong Kong, whether tangible or intangible. This includes real estate, contractual rights and other receivables, securities, bank accounts, intellectual property, ships, aircraft and inventory.

3.2 Is it possible to give asset security by means of a general security agreement or is an agreement required in relation to each type of asset? Briefly, what is the procedure?

A company can execute a debenture (i.e. a single document containing a range of security provisions covering all assets). However, it is also possible to have individual security documents covering particular assets. Generally, the procedure would involve the due execution of the relevant document by the security provider, registration of the document where applicable, and other perfection steps that may be required depending on the type of security. For example, for an assignment of a contract, it is required to provide notice to the assignor's counterparty to perfect the security.

3.3 Can collateral security be taken over real property (land), plant, machinery and equipment? Briefly, what is the procedure?

It is possible to take security over land, and this is most commonly done by taking a legal charge over the property (commonly referred to as a mortgage). The mortgage should be in written form, executed as a deed and specified to be a statutory legal charge. On or before the execution of the mortgage, the mortgagor would have provided title deeds of the property to the mortgagee to facilitate the title investigation. Original title deeds will be retained by the mortgagee until the mortgage is released.

After the mortgage deed is executed, it should be registered with the Land Registry within one month of its execution in order to preserve the priority of the mortgagee against any interests in the land that may arise thereafter.

If the mortgagor/chargor is a Hong Kong incorporated company, or if it is a foreign company registered with the Companies Registry, then it would also be necessary to register the mortgage deed with the Companies Registry within one month of its execution in order to perfect the security.

It is possible to take security over plant, machinery and equipment in Hong Kong, and this would typically be done by a chargor granting a fixed or floating charge over those assets. A charge is a security interest over an asset that does not involve the transfer of ownership to the chargee. Generally speaking, a creditor will prefer to have a fixed charge because this will have a higher priority in the insolvency of the chargor as compared with a floating charge.

However, the nature of a fixed charge requires that the creditor maintain a high degree of control, and the courts may, regardless of whether the deed of charge describes a charge as a fixed charge, recharacterise such charge as a floating charge if it considers that this degree of control is not maintained.

Where a floating charge is used, the chargor is free to deal with the assets. If the chargor parts with ownership, then it will no longer be subject to the charge. The floating charge can crystallise and become a fixed charge if a specified crystallisation event (which would normally include an event of default) occurs.

For an effective charge over plant, machinery or equipment, there is no need to obtain any title documents, or notify any third party of the charge. Where the chargor is a company, it may be necessary to register the deed of charge with the Companies Registry, as in the case of a mortgage deed (please see above).

It is also possible to take a pledge or a lien over plant, machinery or equipment, but because these require physical possession, this is rarely done in a syndicated loan context.

3.4 Can collateral security be taken over receivables? Briefly, what is the procedure? Are debtors required to be notified of the security?

Security can be taken over receivables, and this is usually done by way of an assignment, although a charge can also be used.

Where an assignment is taken, to be a legal assignment, it must comply with the requirements of the Law Amendment and Reform (Consolidation) Ordinance (Cap. 23), including that the assignment is absolute and over the assignor's entire legal interest, the assignment is in writing, the assignment is of a legal debt, and notice of the assignment is given to the contract counterparty. Where one or more of the above criteria is not met, the assignment may be an equitable assignment. This can still be effective security, and could be desirable where it is not practical to serve notice on each of the counterparties (which may be the case where there is a large number). On enforcement of the security, the creditor may wish to perfect the assignment by giving the notice, which will facilitate the collection of any claim, or the enforcement of the assigned rights by the creditor.

It is prudent for the creditor to have the underlying contract giving rise to the receivables reviewed to ensure that there is no prohibition on the assignment of the receivables. If so, then the assignment may not be effective, and it could cause the assignor to be in breach of its obligations under the contract, which could in turn create liabilities for the assignor or render the contract voidable. If an assignment is prohibited, then it may be possible to take security with a charge instead.

If the assignor is a company, the deed of assignment may be registrable with the Companies Registry (see question 3.3).

3.5 Can collateral security be taken over cash deposited in bank accounts? Briefly, what is the procedure?

A creditor will normally take an assignment or a fixed charge over a bank account in Hong Kong. To enhance the chances of having a fixed charge instead of a floating one, it is common to require that withdrawals from the account may only be made with the chargee's consent.

Typically, a notice of assignment or charge to the relevant bank is given at the outset, and such account bank is required to acknowledge the notice. In addition to perfecting the security, this would enhance the control of the creditor. For example, the notice may require the account bank to waive any rights of set-off that it may have, or instruct the account bank that after it is served with an enforcement notice, it should only follow the instructions of the creditor and not those of the assigning or charging debtor.

3.6 Can collateral security be taken over shares in companies incorporated in your jurisdiction? Are the shares in certificated form? Can such security validly be granted under a New York or English law-governed document? Briefly, what is the procedure?

It is possible to take security over shares. Where the shares are certificated, it is common to take a fixed charge over the shares. The chargee would normally require the delivery of the original share certificates, as well as various ancillary documents (such as share transfer forms, directors' resignation letters and written resolutions) to be executed in blank to facilitate enforcement. Otherwise, the procedural requirements are similar to those of other fixed charges.

It is possible for a creditor to take a legal mortgage. This would involve the shares being transferred to the creditor, who is then registered as the owner of the shares. This can be considered the strongest form of share security as it would be very difficult for the mortgagor to arrange to sell the shares to a third party without the consent of the creditor. However, this is not a common form of security as the creditor may not want to deal with any consolidation issues that arise if the company whose shares are charged becomes a subsidiary, and there may be stamping costs involved in the transfer.

For scripless shares, these are generally held in the clearing system, CCASS. In addition to taking a fixed charge over those shares, it would be possible to take an assignment in respect of the account at the broker in which such shares are held. The procedural requirements are substantially similar to those of taking security over a normal bank account. Where a significant proportion of shares in a listed company are the subject of the security, it may be necessary to make a notification to the stock exchange.

It is possible in principle to take security over shares with a New York or English law-governed document, but where the shares are located in Hong Kong, it is generally advisable to use a Hong Kong law-governed security document.

3.7 Can security be taken over inventory? Briefly, what is the procedure?

The forms of security that are available for the taking of security over inventory are broadly the same as those for taking security over plant, machinery and equipment as set out in question 3.3 above. Generally, a floating charge would be most appropriate as the chargor would expect to be able to freely sell the inventory without first having to obtain the consent of the chargee.

3.8 Can a company grant a security interest in order to secure its obligations (i) as a borrower under a credit facility, and (ii) as a guarantor of the obligations of other borrowers and/or guarantors of obligations under a credit facility (see below for questions relating to the giving of guarantees and financial assistance)?

Generally speaking, a Hong Kong company can do all of the above.

3.9 What are the notarisation, registration, stamp duty and other fees (whether related to property value or otherwise) in relation to security over different types of assets?

Notarisation is not required for the creation of security.

A registration fee of HK$340 is payable for each security agreement registered in the Companies Registry. Other registrations may be required against particular assets. Security over land should be registered in the Land Registry (which normally costs HK$230 to HK$450). Security over IP may be registrable in certain IP registers (for example, patents (costing HK$325) and registered trademarks (costing HK$800)).

Stamp duty is generally not payable on the creation of security, though it may be payable on the enforcement of such security. For example, on the transfer of land, and on the transfer of shares, stamp duty may be payable, with the rate depending on the amount of consideration provided.

3.10 Do the filing, notification or registration requirements in relation to security over different types of assets involve a significant amount of time or expense?

The above matters are not normally onerous, and should be straightforward provided they are commenced in good time. Notification requirements in respect of an assignment of contracts can be onerous when there are a large number of contracts being assigned.

3.11 Are any regulatory or similar consents required with respect to the creation of security?

No governmental approvals or consents are required.

3.12 If the borrowings to be secured are under a revolving credit facility, are there any special priority or other concerns?

No, though it is common practice for security documents to contain clauses to clarify that the security applies to any further advances granted under a loan facility.

3.13 Are there particular documentary or execution requirements (notarisation, execution under power of attorney, counterparts, deeds)?

Security over certain asset types are required to be documented in writing (see the above questions with respect to assignments, and mortgages over land). Furthermore, documents containing a power of attorney should also be executed under seal.

As a matter of common practice, security documents are executed as deeds to prevent the document from being invalid due to lack of consideration. Documents may be executed using a power of attorney or in counterparts. Notarisation is not required, but this may be done for authentication purposes.

4 Financial Assistance

4.1 Are there prohibitions or restrictions on the ability of a company to guarantee and/or give security to support borrowings incurred to finance or refinance the direct or indirect acquisition of: (a) shares of the company; (b) shares of any company which directly or indirectly owns shares in the company; or (c) shares in a sister subsidiary?

(a) Shares of the company

If a person is acquiring or proposing to acquire shares in a company incorporated in Hong Kong, the company and any Hong Kong incorporated subsidiaries must not give any financial assistance directly or indirectly for the purpose of the acquisition before or at the same time as the acquisition takes place. Also, if a person has acquired shares in a company incorporated in Hong Kong, and any person has incurred a liability for the purpose of the acquisition, the company or any of its subsidiaries must not give financial assistance directly or indirectly for the purpose of reducing or discharging the liability. In other words, refinancing of loans made available for financing the acquisition is likely to be caught by this prohibition as well.

"Financial assistance" may take many forms and section 274 of the Companies Ordinance (Cap. 622) provides that it includes financial assistance given by way of "guarantee, security or indemnity". This usually prohibits the target company and its Hong Kong incorporated subsidiaries in an acquisition financing from giving guarantees and/or security to secure the facility financing the acquisition that is made available to the purchaser. Certain exceptions apply to this prohibition. This prohibition may also not apply if the company follows one of the three sets of relaxation procedures. The choice of which one to follow depends on the structure of the relevant transaction and timing requirements.

If a company unlawfully gives financial assistance, the validity of the financial assistance and of any transaction connected with it is not affected solely by reason of the contravention of the prohibition on the giving of the financial assistance. However, the company and its responsible persons may be the subject of criminal sanctions if it is found that the restrictions have been breached.

(b) Shares of any company which directly or indirectly owns shares in the company

Please see above.

(c) Shares in a sister subsidiary

The financial assistance prohibition does not apply where the shares acquired are only of a sister company.

5 Syndicated Lending/Agency/Trustee/Transfers

5.1 Will your jurisdiction recognise the role of an agent or trustee and allow the agent or trustee (rather than each lender acting separately) to enforce the loan documentation and collateral security and to apply the proceeds from the collateral to the claims of all the lenders?

Security agency and trust arrangements are recognised. In syndicated lending, security will typically be granted in favour of a bank acting as security trustee on behalf of all syndicate members from time to time. The existence of the trust means there is no need to grant separate security to each lender or to grant new security or make new security registrations each time there is a change in syndicate membership. The security trust provisions will provide that the security trustee (or a receiver appointed by it) is the only party entitled to enforce the security (acting on the instructions of the lenders).

5.2 If an agent or trustee is not recognised in your jurisdiction, is an alternative mechanism available to achieve the effect referred to above which would allow one party to enforce claims on behalf of all the lenders so that individual lenders do not need to enforce their security separately?

This is not applicable in Hong Kong.

5.3 Assume a loan is made to a company organised under the laws of your jurisdiction and guaranteed by a guarantor organised under the laws of your jurisdiction. If such loan is transferred by Lender A to Lender B, are there any special requirements necessary to make the loan and guarantee enforceable by Lender B?

Assuming the loan and guarantee are documented using market standard documentation and the transfer takes place in accordance with their terms, there would be no such special requirements.

6 Withholding, Stamp and Other Taxes; Notarial and Other Costs

6.1 Are there any requirements to deduct or withhold tax from (a) interest payable on loans made to domestic or foreign lenders, or (b) the proceeds of a claim under a guarantee or the proceeds of enforcing security?

These are not applicable in Hong Kong.

6.2 What tax incentives or other incentives are provided preferentially to foreign lenders? What taxes apply to foreign lenders with respect to their loans, mortgages or other security documents, either for the purposes of effectiveness or registration?

No tax incentives exist that provide preferential treatment to foreign lenders, and no special taxes apply to foreign lenders in relation to the effectiveness or registration of security documents.

6.3 Will any income of a foreign lender become taxable in your jurisdiction solely because of a loan to, or guarantee and/or grant of, security from a company in your jurisdiction?

A foreign lender would not be subject to Hong Kong tax solely due to a single loan made to a Hong Kong company. However, if such lender is required to pay profits tax in Hong Kong by reason of its business generally, then it may be taxed on the profit made on the loan. Likewise, a foreign lender would not be subject to Hong Kong tax solely because it benefits from a guarantee or security from a Hong Kong grantor.

6.4 Will there be any other significant costs which would be incurred by foreign lenders in the grant of such loan/guarantee/security, such as notarial fees, etc.?

Please see section 3 above.

6.5 Are there any adverse consequences for a company that is a borrower (such as under thin capitalisation principles) if some or all of the lenders are organised under the laws of a jurisdiction other than your own? Please disregard withholding tax concerns for purposes of this question.

No, there are not.

7 Judicial Enforcement

7.1 Will the courts in your jurisdiction recognise a governing law in a contract that is the law of another jurisdiction (a "foreign governing law")? Will courts in your jurisdiction enforce a contract that has a foreign governing law?

Generally speaking, the Hong Kong courts will recognise a foreign governing law provided this would not be contrary to public policy in Hong Kong. The courts may apply Hong Kong law mandatorily in some circumstances, such as where the subject matter of the dispute relates to real property located in Hong Kong.

7.2 Will the courts in your jurisdiction recognise and enforce a judgment given against a company in New York courts or English courts (a "foreign judgment") without re-examination of the merits of the case?

The Hong Kong courts will generally enforce a final and conclusive foreign judgment without re-examination of the merits, subject to certain exceptions. These include where it would be contrary to public policy, where the foreign judgment was obtained by fraud, and where the judgment relates to foreign penal or revenue laws.

7.3 Assuming a company is in payment default under a loan agreement or a guarantee agreement and has no legal defence to payment, approximately how long would it take for a foreign lender to (a) assuming the answer to question 7.1 is yes, file a suit against the company in a court in your jurisdiction, obtain a judgment, and enforce the judgment against the assets of the company, and (b) assuming the answer to question 7.2 is yes, enforce a foreign judgment in a court in your jurisdiction against the assets of the company?

This will depend on the relative complexity of the facts of the case. If it is straightforward and the defendant does not mount a defence, then the creditor may be able to get default judgment within one month of the initiation of proceedings. If the defendant does mount a defence, then the creditor may be able to get summary judgment within three to nine months. Failing this, the time to get a judgment will depend very much on the facts of the case.

The time to complete an enforcement procedure depends on the procedure chosen, but it can be done in under two months. For foreign judgments, the enforcement process can be completed within four to six months, but it can be considerably longer depending on the circumstances.

7.4 With respect to enforcing collateral security, are there any significant restrictions which may impact the timing and value of enforcement, such as (a) a requirement for a public auction, or (b) regulatory consents?

In general, there are no strict requirements with respect to the timing or value of the enforcement procedure. Public auctions and (except for in the case of very limited classes of assets) regulatory consents would not be required. However, the creditor does have certain duties towards the provider of the security to obtain a reasonable price. In an enforcement situation, the creditor would generally appoint a receiver, have the asset valued independently, and consider holding an auction if appropriate.

7.5 Do restrictions apply to foreign lenders in the event of (a) filing suit against a company in your jurisdiction, or (b) foreclosure on collateral security?

There are no such restrictions applicable specifically to foreign lenders.

7.6 Do the bankruptcy, reorganisation or similar laws in your jurisdiction provide for any kind of moratorium on enforcement of lender claims? If so, does the moratorium apply to the enforcement of collateral security?

In a compulsory winding-up of a company, once a liquidator is appointed, no proceeding may be commenced against the company or its assets without the leave of the court. However, a creditor may appoint a receiver over secured assets, and the court would be expected to grant leave for such receiver to take possession of the assets.

Although rarely seen, where a scheme of arrangement in respect of a company has been agreed by the relevant classes of creditors, and been sanctioned by the court, a moratorium may be put into place in respect of such company's debts in accordance with the terms of the scheme of arrangement. Generally though, no moratorium will come into place until the scheme is effective.

7.7 Will the courts in your jurisdiction recognise and enforce an arbitral award given against the company without re-examination of the merits?

As Hong Kong is considered a party to the New York Convention on the Recognition and Enforcement of Foreign Arbitral Awards (through accession by China), the Hong Kong courts would enforce an arbitral award without re-examination of the merits, assuming that the award was made in a country that was also party to the New York Convention. In such a case, the defendant would not be able to challenge the award on its merits.

8 Bankruptcy Proceedings

8.1 How does a bankruptcy proceeding in respect of a company affect the ability of a lender to enforce its rights as a secured party over the collateral security?

See question 7.6 above, and question 8.2 below.

8.2 Are there any preference periods, clawback rights or other preferential creditors' rights (e.g., tax debts, employees' claims) with respect to the security?

- A transaction may be challenged under Section 265D of the Companies (Winding Up and Miscellaneous Provisions) Ordinance (the "CWMO") where a company which goes into liquidation had at a relevant time entered into a transaction with a person at an undervalue. Transactions at an undervalue can include transactions where the company received no consideration or consideration of a value which is significantly less than the value of the consideration provided by the company. The relevant time is any time during the period of five years ending on the day on which the winding up of the company commences ("Winding-Up Commencement Date"), and where the company was unable to pay its debts or became unable to pay its debts as a result of that transaction.
- Section 266 of the CWMO may invalidate transactions relating to a company's property made at a relevant time if they are deemed to be "unfair preferences" and if the company is ultimately wound up. A company will be regarded as having given an unfair preference if the company does anything or suffers anything to be done which has the effect of putting a person into a position which is better than the position such person would have been in if that thing had not been done. The relevant time for an unfair preference means any time during the six-month period ending on the Winding-Up Commencement Day (or two years if the preference is given to a person connected with the company) where the company was unable to pay its debts at the time the preference was given or became unable to pay its debts as a result of giving that unfair preference.
- Unless an exception applies, section 267 of the CWMO will invalidate any floating charge given by a company at

a relevant time if the company goes into liquidation. The relevant time for this purpose means any time during (a) (for any floating charge in favour of a person not connected with the company), the 12-month period ending on the Winding-Up Commencement Day where the company was unable to pay its debts at the time of the creation of the floating charge or became unable to pay its debts in consequence of the creation of the floating charge, or (b) (for any floating charge in favour of a person connected with the company) a two-year period ending on the Winding-up Commencement Day.

- Upon insolvency, generally, the payment waterfall for creditors is as follows: first, creditors having the benefit of fixed charges and mortgages; second, the payment of liquidation costs (including realisation costs); and third, payments owed to preferential creditors. Payments to preferential creditors include wages, contributions to a mandatory provident fund, the return of deposits where the insolvent company is a bank and payments on insurance claims where the insolvent company is an insurance company. Any surplus remaining after all of these payments have been discharged will be paid to creditors secured by floating charges.

8.3 Are there any entities that are excluded from bankruptcy proceedings and, if so, what is the applicable legislation?

Unregistered companies (which includes foreign companies registered with the Companies Registry) may not be the subject of a voluntary liquidation procedure.

8.4 Are there any processes other than court proceedings that are available to a creditor to seize the assets of a company in an enforcement?

This can be possible, but only in very limited circumstances. A creditor or receiver would not generally be able take possession of an asset without a court procedure, especially where the asset is a physical one. However, there may be circumstances where the security arrangement was established in such a way that the involvement of a court is not required. For example, where a creditor has the benefit of the assignment of a bank account, the creditor may instruct the account bank to make payments to the order of the creditor instead of the assignor.

9 Jurisdiction and Waiver of Immunity

9.1 Is a party's submission to a foreign jurisdiction legally binding and enforceable under the laws of your jurisdiction?

Where the relevant contract provides that a foreign court will have exclusive jurisdiction, the courts of Hong Kong will generally give effect to such choice. However, there may be exceptions; for example where the Hong Kong court found that the choice of jurisdiction was illegal, not made in good faith, or contrary to public policy.

9.2 Is a party's waiver of sovereign immunity legally binding and enforceable under the laws of your jurisdiction?

The doctrine of absolute sovereign immunity applies in Hong Kong.

Waiver of sovereign immunity was considered in the cases of *Hua Tian Long (No 2) and FG Hemisphere Associates LLC v Democratic Republic of the Congo*. These cases suggest that if an obligor can establish to the satisfaction of the courts of Hong Kong that it is entitled to sovereign immunity, then any waiver of that immunity (in respect of jurisdiction, proceedings or execution) given by it in the relevant agreement may not be enforceable.

10 Licensing

10.1 What are the licensing and other eligibility requirements in your jurisdiction for lenders to a company in your jurisdiction, if any? Are these licensing and eligibility requirements different for a "foreign" lender (i.e. a lender that is not located in your jurisdiction)? In connection with any such requirements, is a distinction made under the laws of your jurisdiction between a lender that is a bank *versus* a lender that is a non-bank? If there are such requirements in your jurisdiction, what are the consequences for a lender that has not satisfied such requirements but has nonetheless made a loan to a company in your jurisdiction? What are the licensing and other eligibility requirements in your jurisdiction for an agent under a syndicated facility for lenders to a company in your jurisdiction?

Money lender's licence

Lending business in Hong Kong is governed by the Money Lenders Ordinance. This Ordinance requires every person who carries on business as a money lender to hold a money lender's licence. However, this Ordinance does not apply to authorised institutions (i.e. licensed banks, restricted licence banks and deposit-taking companies approved by the Hong Kong Monetary Authority) nor to loans made to such institutions, and in each such case no licensing under the Ordinance is required.

The licensing requirement in this Ordinance does not apply to certain categories of loans (referred to in the Ordinance as "exempted loans", which include, without limitation, certain secured loans, intra-group lending and loans to employees) and certain categories of persons (referred to in the Ordinance as "exempted persons", which include, without limitation, certain types of financial institutions and insurance companies) making loans. The licensing requirements apply equally whether the lender is based in Hong Kong or overseas.

Any person who carries on a business as a money lender in contravention of the Money Lenders Ordinance is liable to a fine of up to HK$100,000 and imprisonment for up to two years. The lender may also be unable to enforce any relevant loan agreement.

Trust or company service licence

The Anti-Money Laundering and Counter-Terrorist Financing Ordinance introduced a new regime for the licensing of trust and company service providers. Persons who conduct certain defined "trust or company service business" (which could include agency and trustee services in a syndicated loan context) are required to apply for a licence unless they can benefit from one of the statutory exemptions. For example, authorised institutions (which include banks authorised to conduct banking business in Hong Kong) are exempt from having to apply for such a licence.

The licensing requirements include the applicant being satisfied that it, and each partner (if applicable), director and ultimate owner of the applicant are fit and proper to operate a trust and company services.

Any person who carries on a trust or company service business without a licence commits an offence and is liable on conviction to a maximum fine of HK$100,000 and imprisonment for up to six months.

11 Other Matters

11.1 Are there any other material considerations which should be taken into account by lenders when participating in financings in your jurisdiction?

Particular care should be taken when an individual person is providing a guarantee or other security. It is necessary to ensure that the person is properly identified, and that they are of age and sound mind. Furthermore, the Hong Kong Law Society has provided guidelines designed to mitigate the risk of undue influence. Depending on the facts of the case and whether the individual person has separate legal representation, it may be necessary to serve warning notices on them and have them sign confirmations before entering into the transaction documentation.

Going forwards, the Hong Kong market is expected to be affected by the potential retirement of the LIBOR benchmark, and whilst discussions continue with respect to fall-back provisions and amendment regimes in documentation, a significant number of loans are being executed with maturities falling after the expected retirement of LIBOR and it is possible that such loans would require amendments once the outcome is clearer.

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Khin has extensive experience in a wide range of lending transactions including real estate financing, acquisition financing, fund financing, syndicated and bilateral loans, and loan participation notes. He has a particular focus on cross-border lending across Asia Pacific involving jurisdictions such as Hong Kong, PRC, Australia and Singapore.

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Chapter 54

Indonesia


Luky I. Walalangi


Siti Kemala Nuraida

Walalangi & Partners
(in association with Nishimura & Asahi)

1 Overview

1.1 What are the main trends/significant developments in the lending markets in your jurisdiction?

Equity Crowdfunding

Towards the end of 2018, the Financial Services Authority (*Otoritas Jasa Keuangan* or "**OJK**") issued OJK Regulation No. 37/POJK.04/2018 on Equity Crowdfunding, providing companies (particularly start-up companies) with an alternative for fundraising by way of offering equity securities directly to investors via an online platform operated by an equity crowdfunding operator.

Multi-Finance Regulation

In addition, the OJK also issued a new regulation regarding multi-finance companies' activities. Notable highlighted points include the possibility for multi-finance companies to directly disburse cash to their customers.

1.2 What are some significant lending transactions that have taken place in your jurisdiction in recent years?

One of the most prestigious real property financings in 2018 was the financing of the development of apartments and office property in the Dharmawangsa (South Jakarta) area, by a branch of a leading Japanese bank with a total amount of **IDR 2,265,160,000,000**.

2 Guarantees

2.1 Can a company guarantee borrowings of one or more other members of its corporate group (see below for questions relating to fraudulent transfer/financial assistance)?

Subject to certain qualifications on corporate benefit issues, generally it is common in Indonesian practice for an Indonesian company to offer guarantees to its subsidiaries.

2.2 Are there enforceability or other concerns (such as director liability) if only a disproportionately small (or no) benefit to the guaranteeing/securing company can be shown?

Indonesian law recognises the corporate benefit concept where every corporate action of a company must be in line with its constitutional documents and it must give a justification of its benefits. Therefore, when a company enters into a guarantee or a security arrangement, lenders must carefully observe: (i) the company's articles of association; and (ii) a justification stating the company's commercial benefit from the transaction for which the guarantee and third-party security is issued.

In practice, to minimise the risk of a challenge, written consent from each of the company's organs (i.e. the shareholders, board of directors, and board of commissioners) must be obtained.

2.3 Is lack of corporate power an issue?

While the guarantee may still be binding if the parties are acting in good faith, the board of directors may be considered negligent and may be personally liable for any losses of the company.

2.4 Are any governmental or other consents or filings, or other formalities (such as shareholder approval), required?

This very much depends on the company's line of business and its constitutional documents.

2.5 Are net worth, solvency or similar limitations imposed on the amount of a guarantee?

No, but under the Indonesian Civil Code, a guarantor is not liable for anything more than the amount owed by the borrower, and it may guarantee only a part of the amount owed.

2.6 Are there any exchange control or similar obstacles to enforcement of a guarantee?

There are no exchange control obstacles under Indonesian law, but obstacles may occur in the enforcement timeframe. The enforcement of a guarantee is basically similar to the enforcement of a valid contract. A claim/suit must be filed with the court having jurisdiction over the guarantor's domicile or another court agreed by the parties in the guarantee agreement. There are three levels of court (i.e. district court, court of appeal, and Supreme Court) in Indonesia, each level of which could take quite some time to complete.

3 Collateral Security

3.1 What types of collateral are available to secure lending obligations?

There are a number and various classifications of security, depending on the type of asset, but the most common *in rem* security rights in Indonesian financing include:

(1) Immovable assets: mortgage (*Hak Tanggungan*); hypothec (for vessels).

(2) Movable assets: fiduciary security; pledge (*Gadai*).

(3) Intangible movable assets: pledge (*Gadai*).

Personal security is in the form of a guarantee (either a personal or corporate guarantee).

3.2 Is it possible to give asset security by means of a general security agreement or is an agreement required in relation to each type of asset? Briefly, what is the procedure?

Different types of asset require different types of security interest and agreement.

Mortgage

The signing of the mortgage deed must be in the form of a notarial deed in Bahasa Indonesia, made before the Land Conveyancer Officer ("**PPAT**") with jurisdiction over the land to be mortgaged. The executed mortgage deed must then be submitted to the Land Office ("**BPN**") by PPAT at the latest seven days after the execution date.

The mortgage is established once registered in the BPN's land book (the seventh day after the BPN receives the complete mortgage application). The BPN would then issue the mortgage certificate as evidence of registration. In total, the issuance process may take up to eight weeks.

Hypothec for Vessels

Hypothec over vessels should be made by signing a hypothec deed prepared by a Vessel Registration Official at the relevant Director General of Sea Transportation office where the vessel is registered and listed in the Master List of Vessel Registration. The hypothec is effective once registered in the List of Indonesian Vessels (*Buku Daftar Kapal Indonesia*). The registration process takes from three days to two weeks.

Pledge (*Gadai*)

There is no prescribed form; in practice, a pledge is created by a deed of pledge (notarised or executed privately), followed by registration (for pledge of shares) or notification/acknowledgment (for pledge of bank accounts).

Fiduciary Security

A fiduciary transfer takes the form of a notarial deed in Bahasa Indonesia, under which the transferor (borrower) transfers to the transferee (lender) its legal title for security purposes for the period during which the debt remains outstanding. The fiduciary is effective once registered in the Fiduciary Registration Book kept by the Fiduciary Registration Office. On acceptance of the registration application, the applicant will obtain a Fiduciary Security Certificate. It can take from one week to one month for issuance of the certificate. The certificate will be dated the same as the application for registration.

Guarantee

A guarantee is mutually agreed by the parties, and there is no specific prescribed form for such. In practice, a guarantee is created by a written agreement (notarised or privately) between the guarantor and grantee.

3.3 Can collateral security be taken over real property (land), plant, machinery and equipment? Briefly, what is the procedure?

Yes; in the same way as described in question 3.2 above. Mortgages apply to land, and fiduciary security applies for machinery and equipment.

3.4 Can collateral security be taken over receivables? Briefly, what is the procedure? Are debtors required to be notified of the security?

Yes; the most common form of security over receivables is a fiduciary transfer. Please refer to our answer in question 3.2 under "Fiduciary Security".

In the case of a transfer of receivables, notification or acknowledgment from the obligors for the creation of the fiduciary plays a significant part for enforcement purposes.

3.5 Can collateral security be taken over cash deposited in bank accounts? Briefly, what is the procedure?

The most common form of security over cash deposits is a pledge over a bank account using the formalities referred to in our answer to question 3.2 under "Pledge". Nonetheless, the Fiduciary Registration Office does not consider a bank account as an object of a fiduciary security; therefore, the validity of creation of a pledge over a bank account is doubtful.

3.6 Can collateral security be taken over shares in companies incorporated in your jurisdiction? Are the shares in certificated form? Can such security validly be granted under a New York or English law-governed document? Briefly, what is the procedure?

Yes – the most common form of security over shares is a pledge as per question 3.2 under "Pledge".

Not all shares have certificated forms, depending on the company's articles of association, but all shares must be registered in the registry book maintained by the director of the company. The pledge takes effect upon notification of the pledge to the company in which the shares are held, which is normally done by annotation of such pledge in the company's register of shareholders. For enforcement purposes, all Indonesian security agreements must be governed by Indonesian law.

3.7 Can security be taken over inventory? Briefly, what is the procedure?

Yes, inventory is commonly subject to fiduciary transfer using the formalities referred to in our answer to question 3.2 under "Fiduciary Security".

3.8 Can a company grant a security interest in order to secure its obligations (i) as a borrower under a credit facility, and (ii) as a guarantor of the obligations of other borrowers and/or guarantors of obligations under a credit facility (see below for questions relating to the giving of guarantees and financial assistance)?

Yes, subject to the security interest meeting the corporate benefit requirement.

3.9 What are the notarisation, registration, stamp duty and other fees (whether related to property value or otherwise) in relation to security over different types of assets?

Notaries' Fees and Registration Fees

Mortgage

The cost of granting a mortgage consists mainly of the fees payable to the PPAT and BPN which includes the fees for preparation, execution, and registration of the mortgage deed. The fees are generally calculated on a percentage basis of the amount secured by the mortgage (which is commonly chosen by the lender based on the actual value of the assets or the principal amount of the loan).

Hypothec

The main fees payable are the notary and the registration fees, generally calculated based on the size of the vessel.

Fiduciary

The costs are nominal – mainly notary and registration fees.

Pledge

Costs are very nominal – commonly only the notary fees when the parties opt to sign the pledge in a notarial deed.

Stamp Duty

Stamp duty is at a very nominal amount of IDR6,000 (less than US$1).

3.10 Do the filing, notification or registration requirements in relation to security over different types of assets involve a significant amount of time or expense?

This depends on the type of security; the most significant would be a mortgage over land.

3.11 Are any regulatory or similar consents required with respect to the creation of security?

Yes; please refer to our answers to questions 2.2 and 2.5.

3.12 If the borrowings to be secured are under a revolving credit facility, are there any special priority or other concerns?

A security interest is of an accessory nature and is conditional upon the existence of the underlying secured obligation(s). Due to its accessory nature, an Indonesian security cannot secure a future obligation not yet in existence at the time the security is created and the security will be valid as long as the revolving credit facility is valid. Therefore, if the loan is a revolving facility, the lenders need to carefully ensure that the loan is not fully repaid before the period of the loan lapses.

3.13 Are there particular documentary or execution requirements (notarisation, execution under power of attorney, counterparts, deeds)?

Yes; please refer to our answers to questions 3.2, 3.4 and 3.9.

4 Financial Assistance

4.1 Are there prohibitions or restrictions on the ability of a company to guarantee and/or give security to support borrowings incurred to finance or refinance the direct or indirect acquisition of: (a) shares of the company; (b) shares of any company which directly or indirectly owns shares in the company; or (c) shares in a sister subsidiary?

There is no strict regulatory prohibition; but in the case of the above, theoretically, there is uncertainty as to whether the issuance of the guarantee can be regarded an object of that company (*Ultra Vires Doctrine*).

5 Syndicated Lending/Agency/Trustee/Transfers

5.1 Will your jurisdiction recognise the role of an agent or trustee and allow the agent or trustee (rather than each lender acting separately) to enforce the loan documentation and collateral security and to apply the proceeds from the collateral to the claims of all the lenders?

Yes; the role of an agent in relation to loans/financing (especially syndicated loans) is common in Indonesian financing, and as far as Indonesian law is concerned, the agent would be deemed to act for and on behalf of the lenders.

5.2 If an agent or trustee is not recognised in your jurisdiction, is an alternative mechanism available to achieve the effect referred to above which would allow one party to enforce claims on behalf of all the lenders so that individual lenders do not need to enforce their security separately?

This is not applicable in Indonesia.

5.3 Assume a loan is made to a company organised under the laws of your jurisdiction and guaranteed by a guarantor organised under the laws of your jurisdiction. If such loan is transferred by Lender A to Lender B, are there any special requirements necessary to make the loan and guarantee enforceable by Lender B?

Loan transfers can be divided into: (i) assignment of receivables (only) or *cessie*; or (ii) transfer of obligations and rights (novation). If the former, the assignment is effected by an assignment instrument called a *cessie*. The assignment takes place when the assignment agreement is signed by Lender A and Lender B; but in order to bind the borrower to pay the debt directly to Lender A, the assignment must be notified to the borrower (in practice, lenders usually require acknowledgment from the borrower). In this case, the guarantee will automatically follow the assignment and securing Lender B. In contrast, in the event of a novation, the borrower's consent is required by law (by way of a tripartite novation agreement), and the existing guarantee will automatically cease when the novation takes place and therefore a new guarantee must be signed by the guarantor in favour of Lender B.

6 Withholding, Stamp and Other Taxes; Notarial and Other Costs

6.1 Are there any requirements to deduct or withhold tax from (a) interest payable on loans made to domestic or foreign lenders, or (b) the proceeds of a claim under a guarantee or the proceeds of enforcing security?

There are certain registration fees and notarial fees for creation of security interests, but they are relatively nominal, except in the case of land mortgage, the costs of which would depend on the secured amount.

6.2 Are there any adverse consequences for a company that is a borrower (such as under thin capitalisation principles) if some or all of the lenders are organised under the laws of a jurisdiction other than your own? Please disregard withholding tax concerns for purposes of this question.

Strictly from a non-tax regulatory perspective, the answer is negative.

7 Judicial Enforcement

7.1 Will the courts in your jurisdiction recognise a governing law in a contract that is the law of another jurisdiction (a "foreign governing law")? Will courts in your jurisdiction enforce a contract that has a foreign governing law?

Yes, a choice of foreign law for finance documents (other than Indonesian security interests documents, which should be governed by Indonesian law) would be honoured and recognised as binding under the laws of the Republic of Indonesia except (i) to the extent that any term of those documents is manifestly incompatible with the public policy of the Republic of Indonesia, and (ii) if the Indonesian court gives effect to mandatory rules of the laws of another jurisdiction with which the situation has a close connection, if and so far as, under the laws of that other jurisdiction, those rules must be applied, whatever the chosen law.

7.2 Will the courts in your jurisdiction recognise and enforce a judgment given against a company in New York courts or English courts (a "foreign judgment") without re-examination of the merits of the case?

A judgment of a non-Indonesian court will not be enforceable in the Republic of Indonesia although such judgment could be admissible as non-conclusive evidence in proceedings on the underlying claim in an Indonesian court. Re-examination of the issues would be required before an Indonesian court in order to enforce the claim underlying the foreign judgment in the Republic of Indonesia.

7.3 Assuming a company is in payment default under a loan agreement or a guarantee agreement and has no legal defence to payment, approximately how long would it take for a foreign lender to (a) assuming the answer to question 7.1 is yes, file a suit against the company in a court in your jurisdiction, obtain a judgment, and enforce the judgment against the assets of the company, and (b) assuming the answer to question 7.2 is yes, enforce a foreign judgment in a court in your jurisdiction against the assets of the company?

Theoretically, the litigation process in a District Court may take up to five months, and if there is further appeal, it would take the maximum three months in the court of appeal and 250 days in the Supreme Court. Nevertheless, in practice this may take more than the above timeframe given the uncertainty of the Indonesian litigation process.

Part (b) of the question is not applicable in Indonesia.

7.4 With respect to enforcing collateral security, are there any significant restrictions which may impact the timing and value of enforcement, such as (a) a requirement for a public auction, or (b) regulatory consents?

Yes, enforcement of security interests in Indonesia should involve public auctions and, in practice, some auction companies require a court order to proceed. Depending on the type of security interest, private enforcement is generally possible, subject to the consent of the borrowers and certain public announcements; for example, for fiduciary security, a private sale is allowed provided that the fiduciary grantor has consented to such private sale one month after the announcement of such proposed sale in two daily newspapers.

7.5 Do restrictions apply to foreign lenders in the event of (a) filing suit against a company in your jurisdiction, or (b) foreclosure on collateral security?

No, there is no restriction for foreign lenders to file a suit in Indonesia.

7.6 Do the bankruptcy, reorganisation or similar laws in your jurisdiction provide for any kind of moratorium on enforcement of lender claims? If so, does the moratorium apply to the enforcement of collateral security?

There is a moratorium procedure called the Suspension of Debt Payments under Law No. 37 of 2004 on Bankruptcy and Suspended Debt Repayments; but this does not apply to the enforcement of security interests. The suspension can be filed by a debtor or a lender to the commercial court if the debtor/lender believes that debtor cannot continue to repay its debts that have become due and payable, during which period the debtor cannot be forced to repay the debts.

Additionally, bankruptcy does not apply to collateral security unless it is during the 'stay period' of 90 days that commences when a verdict pertaining to a declaration of bankruptcy is read out (the lender can execute its right over the relevant collateral security on the 91st day, and must exercise this right no more than two months after the insolvency condition).

7.7 Will the courts in your jurisdiction recognise and enforce an arbitral award given against the company without re-examination of the merits?

Indonesia is a signatory to the 1958 New York Convention and has adopted such convention into Indonesian law by way of Presidential Decree No. 34 of 1981. Therefore, any final international arbitration award would be recognised without re-examination of the merits pursuant to Law No. 30 of 1999 and the 1958 New York Convention on the Recognition of and Enforcement of Foreign Arbitral Awards (the "**1958 New York Convention**"). However, enforcement of an arbitral award may be denied if:

(a) the award is issued by an arbitrator or arbitration tribunal in a foreign country which is not a signatory to an international convention on the recognition of foreign arbitral awards to which Indonesia is a signatory, or does not have a bilateral arrangement with the Republic of Indonesia for the recognition of arbitral awards on a reciprocal basis;

(b) the award is not on commercial law matters; or

(c) the award is against the public policy of the Republic of Indonesia.

To enforce the award, it is necessary to register the award with the Clerk of Central Jakarta District Court, obtain a writ of execution (known as an *Exequatur*) from the Chairman of the Central Jakarta District Court or, in case the award involves the Government of the Republic of Indonesia as one of the parties in the dispute, from the Supreme Court of the Republic of Indonesia (through the Central Jakarta District Court).

8 Bankruptcy Proceedings

8.1 How does a bankruptcy proceeding in respect of a company affect the ability of a lender to enforce its rights as a secured party over the collateral security?

Please refer to our answer to question 7.6.

8.2 Are there any preference periods, clawback rights or other preferential creditors' rights (e.g., tax debts, employees' claims) with respect to the security?

Bankruptcy creditors are ranked in three categories in the following order: (i) those with special rights based on laws and regulations (e.g. tax claims and collections); (ii) preferred creditors (i.e. secured creditors); and (iii) concurrent creditors (i.e. non-secured creditors).

8.3 Are there any entities that are excluded from bankruptcy proceedings and, if so, what is the applicable legislation?

There are no entities excluded from bankruptcy proceedings.

8.4 Are there any processes other than court proceedings that are available to a creditor to seize the assets of a company in an enforcement?

There are no other proceedings available to a creditor.

9 Jurisdiction and Waiver of Immunity

9.1 Is a party's submission to a foreign jurisdiction legally binding and enforceable under the laws of your jurisdiction?

Yes; as long as it does not contradict Indonesian public policy. Under Indonesian law, parties to an agreement are free to choose the laws which govern their agreements, provided that the law chosen has a relationship with the agreement or to the parties to that agreement and provided that the choice of law is not contrary to Indonesian public order.

9.2 Is a party's waiver of sovereign immunity legally binding and enforceable under the laws of your jurisdiction?

Yes; however, sovereign immunity has not been explicitly legislated in Indonesia, although the Republic of Indonesia has subscribed to the doctrine of restrictive sovereign immunity by its entry into the Convention on the Settlement of Investment Disputes between States and Nationals of other States of 1965.

10 Licensing

10.1 What are the licensing and other eligibility requirements in your jurisdiction for lenders to a company in your jurisdiction, if any? Are these licensing and eligibility requirements different for a "foreign" lender (i.e. a lender that is not located in your jurisdiction)? In connection with any such requirements, is a distinction made under the laws of your jurisdiction between a lender that is a bank *versus* a lender that is a non-bank? If there are such requirements in your jurisdiction, what are the consequences for a lender that has not satisfied such requirements but has nonetheless made a loan to a company in your jurisdiction? What are the licensing and other eligibility requirements in your jurisdiction for an agent under a syndicated facility for lenders to a company in your jurisdiction?

It is not necessary for a foreign lender to establish a place of business (or be licensed) for merely extending a loan to an Indonesian borrower, unless it has an operation in the Republic of Indonesia.

11 Other Matters

11.1 Are there any other material considerations which should be taken into account by lenders when participating in financings in your jurisdiction?

Obligation for DULN (Foreign Exchange from Offshore Loan) Withdrawal Through Foreign Exchange Banks

The regulation requires that each DULN in the form of a fund originates from (i) an offshore loan based on a non-revolving agreement, or (ii) an offshore loan based on debt securities, and the difference between the new value of the offshore loan and refinancing over the previous value of the offshore loan is to be withdrawn through a Foreign Exchange Bank in Indonesia (a bank licensed by Bank Indonesia to carry out foreign exchange banking activities).

Currency Conversion for the Repayment

There are some requirements for conversion of IDR into a foreign currency. The regulations allow a party to purchase foreign currency up to maximum amount of or equal to:

(i) USD 25,000 per month for spot transactions;

(ii) USD 100,000 per month for derivative transactions;

(iii) USD 5,000,000 per month for forward transactions; and

(iv) USD 1,000,000 per month for option transactions.

A party may purchase foreign currency exceeding the above threshold, but in doing so, supporting documents as listed below must be presented to Bank Indonesia, and with a maximum amount required under the underlying transaction:

(i) a copy of the underlying agreement, i.e., the loan agreement;

(ii) tax registration number (*Nomor Pokok Wajib Pajak*); and

(iii) a duly stamped and signed statement from the party:

(1) confirming that the underlying agreement is an authentic and valid document and the utilisation of the underlying transaction for the purchase of foreign currencies against IDR shall not exceed the nominal value of the underlying transaction;

(2) setting out the purpose of utilisation and date of foreign currencies utilisation, in case the underlying transaction is an estimation; and

(3) setting out the source of funds, sales amount and time in obtaining the foreign currencies, in case the underlying transaction is an estimation.

Offshore Loan Report

A borrower obtaining an offshore loan is subject to certain reporting requirements which must be submitted to Bank Indonesia on a monthly basis at the latest on the 15th day of the following month, and additionally there will be a training session held by Bank Indonesia prior to the first report's submission.

Prudence Principles Requirement and Report

In addition to the above report, a borrower receiving an offshore loan must implement certain principal requirements:

(i) Minimum Hedging Ratio

The borrower must meet a minimum hedging ratio of 25% of the negative difference between its foreign exchange assets and its foreign exchange liability exceeding USD 100,000 (or its equivalent), which is due (i) within three months ahead the end of the relevant quarter, and (ii) in the next three to six months ahead the end of the relevant quarter.

In doing so, the borrower is required to enter into a hedging transaction (in the form of foreign exchange derivative transaction against Rupiah, i.e., forward, swap and/or option) with Indonesian banks. Exemptions to the above regulation apply if the borrower: (i) maintains financial records in USD; (ii) has previous year export income 50% greater than its other business revenues; and (iii) obtains an approval from the Minister of Finance to maintain USD financial records (the borrower must submit this approval to Bank Indonesia for the exemption).

(ii) Minimum Liquidity Ratio

The borrower must maintain at least a 70% liquidity ratio of foreign exchange assets to foreign exchange liability, which is due within three months of the end of the relevant quarter.

(iii) Minimum Credit Rating

The borrower must have a credit rating of at least "BB-" issued by a credit rating company acknowledged by Bank Indonesia.

In relation to the above, the borrower is required to submit: (i) quarterly and annual reports on the implementation of the Prudence Principles (for the annual report: it must be assessed through an attestation procedure by an independent public accountant); (ii) reports of the credit rating, including information on the credit rating, time of rating, and name of the rating agency, by the end of the following month after the execution of the loan agreement or disbursement; and (iii) a quarterly unaudited financial report and an annual audited financial report. The quarterly report must be submitted at the latest in the third month following the relevant quarter and the annual report is to be submitted at the latest by the end of June after the end of the relevant year.

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The authors would like to thank Putri Bening Larasati for her invaluable assistance in the writing of this chapter. Ms. Putri Bening Larasati is a licensed lawyer with more than five years of experience. During her years of practice, Ms. Putri Bening Larasati assisted and advised domestic and foreign companies in various notable transactions predominantly in the areas of Mergers & Acquisitions, Real Estate, General Corporate and Antitrust.

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Walalangi & Partners (W&P) was founded by Mr. Luky I. Walalangi, a highly regarded lawyer with nearly two decades of experience. W&P is a corporate firm focusing on M&A, Banking & Finance, Real Property, FDI, Antitrust, Debt & Corporate Restructuring, Capital Markets, Employment, General Corporate and TMT.

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Ireland

Conor Keaveny

Dillon Eustace

Richard Lacken

1 Overview

1.1 What are the main trends/significant developments in the lending markets in your jurisdiction?

Alternative finance continues to be a developing sphere in the Irish lending market. Crowdfunding is an area of increasing interest, with Ireland's first equity crowdfunding platform – Spark, which is aimed at those looking to invest in startups with small amounts of money – having launched in 2018. Although not currently regulated in Ireland, the European Commission has proposed a pan-European regulatory regime for crowdfunding and brought a proposal for an EU framework on crowd and peer-to-peer finance for discussion in March 2018. The Department of Finance has stated that it will monitor the progress and developments on this and implement European regulations as necessary. Loan and financing activity levels remain high; domestically, sectors such as real estate and health care are particularly active while aviation and acquisition finance are among the sectors of most cross-border activity.

There have been notable legal/regulatory developments too – for example, unregulated entities (other than securitisation special purpose vehicles which are exempt) that hold title to Irish loans and/or control the overall strategy or key decisions relating to such credit must now be authorised and regulated by the Central Bank of Ireland (the "**CBI**"). Firms providing certain services, which are already obliged to comply with anti-money laundering and counter-terrorist financing obligations even though they may not be authorised or licensed by the CBI, are required to register with the CBI unless they qualify for an exemption. The new requirement brings the firms (so-called "**Schedule 2 Firms**") into closer engagement with the CBI and increases regulatory focus on such entities.

The Securitisation Regulation (Regulation EU 2017/2401) came into force on 17 January 2018 and is now directly applicable across the EU since 1 January 2019. The new rules will apply in a harmonised manner to all securitisations, securitising entities, and EU-regulated institutional investors. The Regulation sets down new rules relating to due diligence, risk retention, transparency and credit granting.

The impact of Brexit on Ireland, while yet unknown, could present significant opportunities for the Irish lending market. This is so particularly given Ireland's common law system and its geographic location, being close to Britain and mainland Europe, which make it an attractive destination for international banks, currently operating out of the UK, which want to maintain an EU presence post-Brexit.

1.2 What are some significant lending transactions that have taken place in your jurisdiction in recent years?

There has been a strong level of transactional activity, both domestically and cross-border, across multiple asset classes. As noted above, real estate finance has been an area of particular focus, particularly commercial investment and residential development (the latter being a sector in which non-bank lenders have been especially active). Notable transactions in this space have included the development of a landmark new hotel at Dublin Airport, a flagship mixed use development in Dublin's central business district and a significant number of student accommodation units in Dublin city, in all of which Dillon Eustace acted. The health care sector has also seen significant activity levels including a cross-border financing for the Centric Health group, a Dillon Eustace client. Noteworthy transactions continue to be completed in the non-performing loan space, such as PTSB's securitisation of a portfolio of non-performing loans with a gross balance sheet value of approximately €1.3 billion in which Dillon Eustace acted.

2 Guarantees

2.1 Can a company guarantee borrowings of one or more other members of its corporate group (see below for questions relating to fraudulent transfer/financial assistance)?

Yes; however, this is subject to the corporate benefit rule (discussed at question 2.2 below), to certain provisions of the Companies Act 2014 (as amended) (the "**Act**") relating to the provision of financial assistance (discussed at question 4.1 below) and to certain provisions of the Act relating to transactions with directors which require, among other things, that both the guarantor and the borrower fall within the concept of "group" companies for the purposes of the Act.

2.2 Are there enforceability or other concerns (such as director liability) if only a disproportionately small (or no) benefit to the guaranteeing/securing company can be shown?

Although not specifically addressed in the Act, it is generally accepted that Irish companies must derive some form of corporate benefit from transactions into which they enter. Accordingly, prior to authorising the provision of a guarantee/security to a third party, directors should consider, and document such considerations of, the commercial benefit that will accrue to the company as a result of providing such security. Directors who authorise a transaction which does not benefit the company may be liable for breach of their statutory and fiduciary duties. In the context of a guarantee of the borrowings of another corporate group member, it is often possible to establish sufficient corporate benefit if the provision of the guarantee/security would benefit the group as a whole. For example, a holding company which guarantees the obligations of its subsidiary could feasibly expect to benefit from the success of that subsidiary through increased dividends.

2.3 Is lack of corporate power an issue?

Generally no, as the doctrine of *ultra vires* has been abolished by the Act and accordingly an Irish company limited by shares has, subject to all applicable laws, the same capacity as an individual. However, the Act introduced a new type of private company – a Designated Activity Company ("**DAC**") – which must (similar to a public limited company) have an objects clause which sets out the specific powers of the company. If it is not specifically stated in the objects clause of such a company that it has the power to issue a guarantee or grant security, then any such action by the company could be subject to challenge by a shareholder of that company. While this in itself should not impact the validity or enforceability of the guarantee/security, there is a risk that the third-party lender may become indirectly involved in a dispute between a company and its shareholders. In addition to this, any liquidator appointed to a company, which has granted security in breach of its objects clause may, in certain circumstances, have clawback rights under the Act which could potentially result in the security being set aside (see question 8.2 below).

2.4 Are any governmental or other consents or filings, or other formalities (such as shareholder approval), required?

Generally no, subject to the provisions of the Act relating to financial assistance and transactions with directors. However, if the company is regulated or subject to the supervision of the CBI or some other regulatory authority, additional consents may be required. For example, an Irish regulated fund cannot give "guarantees" to support the obligations of a third party (which may include another sub-fund within the same umbrella fund structure). While, the term "guarantees" when used in this context is not defined, it is generally accepted that this term includes any security provided to support the obligations of a third party. In terms of formalities, a guarantee must be in writing and must be executed as a deed. Execution as a deed is important for a number of reasons; for example, to remove any concerns about the adequacy of the consideration passing to the guarantor.

2.5 Are net worth, solvency or similar limitations imposed on the amount of a guarantee?

No; however, in certain circumstances a guarantee may be set aside as an unfair preference or due to the insolvency of the company (see question 8.2 below).

2.6 Are there any exchange control or similar obstacles to enforcement of a guarantee?

Generally, no (subject to the application of anti-money laundering, anti-terrorism, anti-corruption and human rights laws and regulations, and any restrictions on financial transfers arising from any United Nations, EU and Irish sanctions).

3 Collateral Security

3.1 What types of collateral are available to secure lending obligations?

In principle, all assets of an Irish company are available to secure lending, subject to any contractual restrictions to which a company might be bound. The most common forms of security taken by a lender are:

(i) **Mortgage**: there are essentially two types of mortgage – a legal mortgage and an equitable mortgage. A legal mortgage involves the transfer of legal title to an asset by a debtor, by way of security, upon the express or implied condition that legal title will be transferred back to the debtor upon the discharge of its obligation. An equitable mortgage on the other hand involves the transfer of the beneficial interest in the asset to the mortgagee with legal title remaining with the debtor and, as such, creates an equitable security interest only. Mortgages are commonly taken over shares, aircraft and ships.

(ii) **Charge**: this represents an agreement between a creditor (chargee) and a debtor (chargor) to appropriate and look to an asset and its proceeds to discharge indebtedness. The principle difference between a mortgage and a charge is that a charge need not involve the transfer of ownership in the asset. A charge may be fixed (i.e. security attaches to a specific asset) or floating (i.e. security floats over the asset leaving the chargor free to deal with it until, upon the occurrence of certain defined events, the charge crystallises into a fixed charge) in nature. A fixed charge can be created by a company or an individual, whereas a floating charge can only be created by a company. It is also worth noting that a floating charge ranks behind certain preferential creditors such as the Irish Revenue Commissioners ("**Revenue**") and employees of the chargor in respect of unpaid wages, etc.

(iii) **Assignment**: this is akin to a mortgage in that it transfers the legal or beneficial ownership in an asset to the creditor upon the understanding that ownership will be assigned back to the debtor upon discharge of the secured obligation owing to the creditor. Assignments are most commonly utilised in the context of intangible assets such as receivables, book debts and other choses in action. Assignments to a creditor are sometimes referred to as security assignments to distinguish them from absolute assignments where the ownership is being assigned by way of sale for value. In order to be a valid and effective legal assignment, as opposed to an equitable assignment, there must be absolute assignment (although it can be stated to be by way of security), it must be in writing under hand of the assignor, and express notice in writing must be given to the third party from whom the assignor would have been entitled to receive or claim the right which is assigned.

(iv) **Others**: to include a pledge, lien, chattel mortgage, bill of sale and retention of title.

3.2 Is it possible to give asset security by means of a general security agreement or is an agreement required in relation to each type of asset? Briefly, what is the procedure?

Security over all, or substantially all, of a company's assets usually takes the form of an "all-assets" debenture, which is a single security document entered into by a company in favour of the secured party(-ies) to create security (e.g. a combination of mortgages, assignments and/or fixed and floating charges) over the borrower's assets. The debenture will usually include: (i) a fixed charge over specific assets which are identifiable and can be controlled by the lender (e.g. buildings, restricted accounts, intellectual property assets); (ii) a floating charge over fluctuating and less identifiable assets (e.g. inventory); (iii) an assignment of any interest in receivables, contracts, insurance policies and bank accounts; and (iv) a mortgage and/or charges over real estate and shares.

3.3 Can collateral security be taken over real property (land), plant, machinery and equipment? Briefly, what is the procedure?

Yes. Security over real property, plant, machinery and equipment is most commonly taken by way of fixed charge. Where security is created over real estate which is registered in the Property Registration Authority of Ireland ("**PRAI**"), an additional prescribed form is also required to validly create the security.

3.4 Can collateral security be taken over receivables? Briefly, what is the procedure? Are debtors required to be notified of the security?

Security over receivables most commonly takes the form of a legal assignment and is permitted so long as the underlying contract creating the receivable does not contain a prohibition on assignment. In order to be a valid legal assignment, certain requirements (as outlined in question 3.1 above) must be adhered to, including the provision of written notice to the third party from whom the assignor would have been entitled to receive or claim the assigned right (the "**Underlying Debtor**"). An assignment not meeting these criteria is deemed to be an equitable assignment. One of the disadvantages of an equitable assignment is that the rights of the assignee will be subject to any equity (such as rights of set-off) already vested in the Underlying Debtor. In addition, should the Underlying Debtor pay off a debt due to the assignor and claim a good discharge of this debt, in circumstances where no notice of the assignment was given to the Underlying Debtor, then the assignee would solely reliant on the assignor passing this payment on.

3.5 Can collateral security be taken over cash deposited in bank accounts? Briefly, what is the procedure?

Yes. This can take the form of a security assignment, fixed charge or floating charge. Taking a fixed charge over a "blocked" account would generally be considered the most effective form of security a lender could take. A blocked account is one where the chargor is prohibited from withdrawing, transferring or otherwise dealing with the account without the prior consent of the chargee. Given that commercial borrowers generally need ready access to their bank accounts for normal trading purposes, it is more usual that the chargee will accept a floating charge over the trading bank account which allows the chargor to retain control over the cash until such time as a trigger event (e.g. an event of default under the loan documents) causes the floating charge to crystallise.

For a security assignment, a notice of assignment must be served on the account-holding bank informing them that the account has been assigned in order to create a legal security interest. In some instances, the secured party(-ies) and the account-holding bank may agree an account control agreement or similar document regarding the operation of the assigned account.

A notification in relation to book debts should also be filed with Revenue, under s.1001(3) of the Taxes Consolidation Act 1997 within 21 days of the creation of charge to put it on notice of the creation of the charge and to protect the chargee's interests should the chargor default on certain tax obligations in the future.

3.6 Can collateral security be taken over shares in companies incorporated in your jurisdiction? Are the shares in certificated form? Can such security validly be granted under a New York or English law-governed document? Briefly, what is the procedure?

Security can be taken over shares issued by an Irish company. There are two main types of security over shares: a legal mortgage and an equitable mortgage. An equitable mortgage – which does not transfer legal ownership and as such does not require the lender to be registered in the company's share register as owner of the shares – is the most common. This is effected by delivery of share certificates and signed but undated share transfer forms, irrevocable proxies and various other deliverables which authorise the lender to complete the undated stock transfer form and any formalities required to become legal holder of the shares if the security becomes enforceable. Prior to the security becoming enforceable, all voting rights, dividends and any communication about the shares will remain with the chargor. It is common for a lender to also take a fixed charge over shares issued by an Irish company. This is commonly taken alongside an equitable mortgage.

Shares may be issued in certificated or uncertificated form; however, ordinarily in the case of a private limited company (which includes a DAC), shares will be issued in certificated form. A public limited company whose shares are listed on a Stock Exchange will issue shares in uncertificated form (which will be held in a clearing system).

While Irish law does not strictly require that share security be granted under an Irish law governed document, it is almost always the case that Irish law-governed security is taken over shares in an Irish incorporated company, given that Irish law is likely to govern the validity and perfection requirements of the security.

3.7 Can security be taken over inventory? Briefly, what is the procedure?

Yes, this typically takes the form of a floating charge given that the chargor trading company needs to retain sufficient freedom to deal with inventory in the ordinary course of business.

3.8 Can a company grant a security interest in order to secure its obligations (i) as a borrower under a credit facility, and (ii) as a guarantor of the obligations of other borrowers and/or guarantors of obligations under a credit facility (see below for questions relating to the giving of guarantees and financial assistance)?

Yes, subject to certain provisions of the Act relating to transactions with directors and the prohibition on the provision of financial assistance (discussed at question 4.1 below), the corporate benefit rule (discussed at question 2.2 above) and solvency considerations (see question 8.2 below).

3.9 What are the notarisation, registration, stamp duty and other fees (whether related to property value or otherwise) in relation to security over different types of assets?

Subject to certain exceptions set out in the Act, particulars of charges created by an Irish company over its assets must be registered at the Irish Companies Registration Office ("**CRO**") in the form prescribed within 21 days of its creation. This does not apply to security over certain financial assets, such as cash and shares. Particulars of any charges created by an Irish Collective Asset-management Vehicle ("**ICAV**") must be filed in the form prescribed (form CH1) with the CBI within 21 days of the creation of the security. Failure to do so will render the charge void against any liquidator or creditor of the company/ICAV. A filing fee of €40 is payable to the CRO in respect of each security registration. No filing fees are incurred in respect of a form CH1. As mentioned in question 3.5 above, where security comprises a fixed charge over book debts, a notification should be made to Revenue within 21 days of the creation of the charge. No fee is incurred in respect of such notification.

Security over real property must be registered at the PRAI and security over certain other assets, such as IP, ships and aircraft, needs to be registered at applicable registries. There are no notarisation requirements for security documents under Irish law.

See section 6 regarding stamp duty.

3.10 Do the filing, notification or registration requirements in relation to security over different types of assets involve a significant amount of time or expense?

Generally, no, as prescribed forms are provided in most instances and filing fees are nominal. However, the filing requirements (for example of the CRO and PRAI) are very prescriptive and any errors in the forms can cause delays, extra expense and in the worst case may render the security void, necessitate an application to court for an order rectifying the particulars or require the parties to put new security in place.

3.11 Are any regulatory or similar consents required with respect to the creation of security?

Generally no, assuming the underlying contracts do not require any such third-party consents. See also question 2.4 above in relation to regulated entities. Regulated entities may be restricted from creating security over certain assets.

3.12 If the borrowings to be secured are under a revolving credit facility, are there any special priority or other concerns?

Generally no, provided the security is properly perfected at the time it was granted and the underlying security documents stipulate any repayment under the facility does not serve to extinguish the security, which should be expressed to secure all amounts owing from time to time.

3.13 Are there particular documentary or execution requirements (notarisation, execution under power of attorney, counterparts, deeds)?

In general, Irish law security documents are executed as deeds to remove any concerns about the adequacy of the consideration. Other guidelines should be considered, such as Law Society practice notes and recent case law in relation to virtual completion and signing, for example the decision in the English case of *R (on the application of Mercury Tax Ltd) v Revenue and Customs Commissioners [2008] EWHC 2721*. It is generally accepted in Ireland that a previously executed signature page from one document may not be transferred to another document, even where the documents in question are simply updated versions of the same document.

4 Financial Assistance

4.1 Are there prohibitions or restrictions on the ability of a company to guarantee and/or give security to support borrowings incurred to finance or refinance the direct or indirect acquisition of: (a) shares of the company; (b) shares of any company which directly or indirectly owns shares in the company; or (c) shares in a sister subsidiary?

(a) Shares of the company

Yes, s.82(2) of the Act creates a general prohibition on the provision by a company (either directly or indirectly) of financial assistance – whether in the form of loans, guarantees, the provision of security or otherwise – for the purpose of the acquisition of its own shares or the shares in its holding company. There are exceptions and s.82(5) allows the financial assistance where the company's principal purpose in giving the assistance is not for the purpose of the acquisition or where it is incidental in relation to some larger purpose and the assistance is given in good faith. S.82(6) also provides a list of exemptions to the prohibition which includes the carrying out of a "Summary Approval Procedure" which allows an otherwise prohibited transaction to proceed.

(b) Shares of any company which directly or indirectly owns shares in the company

Yes, s.82 of the Act applies in respect of the acquisition by a company of shares in its holding company.

(c) Shares in a sister subsidiary

No – this is not applicable.

5 Syndicated Lending/Agency/Trustee/Transfers

5.1 Will your jurisdiction recognise the role of an agent or trustee and allow the agent or trustee (rather than each lender acting separately) to enforce the loan documentation and collateral security and to apply the proceeds from the collateral to the claims of all the lenders?

Yes. Syndicated lending arrangements involving the appointment of a security agent to hold any security on trust for the benefit of all lenders and any other parties entitled to benefit from the security are common in the Irish lending market. However, it is worth noting that under Irish law it is usually the receiver appointed by the lender/security agent over the secured assets who realises the same on behalf of the secured parties. The Irish security document will usually provide for the appointment of a receiver and will usually provide that the receiver is the agent of the borrower rather than the lender(s)/security agent – this is noteworthy as it means that the lender/security agent is protected against any potential claims arising from the actions of the receiver as part of the enforcement.

5.2 If an agent or trustee is not recognised in your jurisdiction, is an alternative mechanism available to achieve the effect referred to above which would allow one party to enforce claims on behalf of all the lenders so that individual lenders do not need to enforce their security separately?

This is not applicable in Ireland.

5.3 Assume a loan is made to a company organised under the laws of your jurisdiction and guaranteed by a guarantor organised under the laws of your jurisdiction. If such loan is transferred by Lender A to Lender B, are there any special requirements necessary to make the loan and guarantee enforceable by Lender B?

Secured debts can be assigned, transferred or novated under Irish law. As the security provider must be provided with notice of the assignment, it is not unusual for the security provider to be a party to the transfer or novation.

6 Withholding, Stamp and Other Taxes; Notarial and Other Costs

6.1 Are there any requirements to deduct or withhold tax from (a) interest payable on loans made to domestic or foreign lenders, or (b) the proceeds of a claim under a guarantee or the proceeds of enforcing security?

(a) Interest payable on loans made by domestic or foreign lenders

A company making a payment of yearly interest from an Irish source is required to withhold Irish income tax from that interest at a rate of 20%.

For these purposes, yearly interest is taken to be interest on a debt, the duration of which is at least one year, or is capable of lasting for a year or more. Interest will have an Irish source if it is paid by an Irish company or branch or the debt is secured on Irish land or buildings.

Notwithstanding the above, there are extensive exemptions under Irish tax legislation from the obligation to withhold tax where interest is paid to domestic or foreign lenders such that, in many circumstances, Irish withholding tax does not apply (assuming relevant conditions are met).

(b) Proceeds of a claim under a guarantee or the proceeds of enforcing security

From relevant case law in the area, it is not clear as to whether a payment made under a guarantee should constitute an interest payment (i.e. the guarantor being deemed to step into the shoes of the borrower) or, alternatively, whether it should to be considered a payment derived from a separate and distinct legal obligation. If the former, the analysis at (a) above should apply. Conversely, if the latter applies (such that the payment is not considered interest), Irish withholding tax should generally not apply.

With regard to the proceeds of enforcing security, to the extent that the security being disposed of is Irish lands or buildings or shares deriving their value from Irish land or buildings, there is a requirement for the purchaser to withhold tax at the rate of 15% from the proceeds. This withholding tax can be avoided if (i) the proceeds from the sale do not exceed €500,000 (€1,000,000, in the case of the disposal of residential property), or (ii) assuming certain conditions are met, the vendor applies for and obtains a CGT Clearance Certificate from Revenue and the vendor provides this certificate to the purchaser.

Where security is enforced, tax must be paid by the vendor on any gains arising in priority to any secured liability.

6.2 What tax incentives or other incentives are provided preferentially to foreign lenders? What taxes apply to foreign lenders with respect to their loans, mortgages or other security documents, either for the purposes of effectiveness or registration?

There are no tax incentives provided preferentially to foreign lenders and no taxes generally apply to their loans, mortgages and security documents for the purposes of effectiveness or registration.

No Irish stamp duty arises on the origination or novation of a loan. However, in very limited circumstances, stamp duty might arise on the acquisition of a loan by way of assignment.

6.3 Will any income of a foreign lender become taxable in your jurisdiction solely because of a loan to, or guarantee and/or grant of, security from a company in your jurisdiction?

Pursuant to general Irish tax rules, unless otherwise exempt, any foreign lender in receipt of Irish source interest income would be liable to Irish income tax. Notwithstanding this, Irish domestic tax legislation provides for exemptions from such income tax where the lenders are resident in EU Member States or in a territory that has signed a double taxation agreement with Ireland. In addition, an exemption may be available under a double taxation agreement itself.

Based on current Revenue guidance, a gain arising on the disposal by a foreign lender of a loan secured on Irish land or buildings may be subject to Irish capital gains tax. In addition, there may be a requirement for the purchaser to withhold tax at the rate of 15% on the proceeds (please refer to question 6.1 above and the discussion there regarding withholding tax on the proceeds of enforcing security). This is a highly technical area and, where applicable, specialist advice should be sought.

6.4 Will there be any other significant costs which would be incurred by foreign lenders in the grant of such loan/guarantee/security, such as notarial fees, etc.?

No; see question 3.9 above.

6.5 Are there any adverse consequences for a company that is a borrower (such as under thin capitalisation principles) if some or all of the lenders are organised under the laws of a jurisdiction other than your own? Please disregard withholding tax concerns for purposes of this question.

Irish tax legislation does not specifically provide for thin capitalisation or similar rules. However, in certain cases, interest paid to a foreign lender which owns 75% or more of the shares in the relevant Irish borrower, could be regarded as a distribution and, therefore, would not be tax deductible for the borrower. Notwithstanding this, there are various circumstances where these rules are disapplied including where the lender is resident in an EU Member State or pursuant to the provisions of a double taxation agreement.

7 Judicial Enforcement

7.1 Will the courts in your jurisdiction recognise a governing law in a contract that is the law of another jurisdiction (a "foreign governing law")? Will courts in your jurisdiction enforce a contract that has a foreign governing law?

Generally, the Irish courts respect and recognise the governing law chosen by parties to a contract. In this regard, Rome I Regulation (Regulation (EC) No. 593/2008 ("**Rome I**") governs the position with respect to contracts relating to civil and commercial matters involving EU Member State parties and provides that, subject to certain limitations, a contract will be governed by the law chosen by the parties. The choice of law in contract disputes falling outside Rome I will be determined by common law, unless there is a specific law or convention which deals with the particular contract in question. Again, the common law generally recognises and enforces the choice of governing law provided for in the contract, subject to certain qualifications such as where there are public policy issues.

The Irish courts can enforce a contract that has a foreign governing law. However, the party seeking to rely on the foreign law will need to provide evidence to the court to prove to the satisfaction of the court what the foreign law is. Generally, the Irish court will not research the foreign law.

7.2 Will the courts in your jurisdiction recognise and enforce a judgment given against a company in New York courts or English courts (a "foreign judgment") without re-examination of the merits of the case?

Generally, yes. The recognition and enforcement of foreign judgments in Ireland is determined by international conventions and treaties. In this regard and broadly speaking, there are three categories of jurisdiction being: (i) judgments from states within the EU; (ii) judgments from states which are party to the Lugano Convention; and (iii) judgments from states not within the EU or not a party to the Lugano Convention. Irrespective of which category of jurisdiction a judgment falls within, an application can be made to the Irish courts to have the foreign judgment recognised in Ireland without re-litigating the facts of the case.

As New York falls within category (iii), an application can be made to have the foreign judgment recognised in Ireland. In order for the judgment to be deemed enforceable in Ireland, the Irish courts will have to determine, amongst others, that: (i) the court in which the judgment is made had competent jurisdiction; (ii) the judgment is for a definite sum of money; (iii) the judgment is final and conclusive; and (iv) it is not contrary to public policy in Ireland.

For as long as England is an EU Member State, a judgment made in England can be enforced in Ireland without any declaration of enforceability being required pursuant to Regulation (EU) No 1215/2012 ("**Brussels I**"). In this regard, judgments made in England are effectively treated like a judgment made by a court in Ireland. The position will have to be reviewed post-Brexit.

7.3 Assuming a company is in payment default under a loan agreement or a guarantee agreement and has no legal defence to payment, approximately how long would it take for a foreign lender to (a) assuming the answer to question 7.1 is yes, file a suit against the company in a court in your jurisdiction, obtain a judgment, and enforce the judgment against the assets of the company, and (b) assuming the answer to question 7.2 is yes, enforce a foreign judgment in a court in your jurisdiction against the assets of the company?

Once the Irish court has jurisdiction to determine the matter, the timing for obtaining a judgment on foot of a debt outstanding pursuant to a loan agreement or guarantee will firstly depend on the monetary amount for which the creditor is seeking judgment as the court system is divided into a number of courts with each having different monetary jurisdiction. Each of the courts also has its own distinct rules but each has a special procedure available to creditors to recover a debt or liquidated amount. Furthermore, obtaining judgment will depend on whether the debtor enters an appearance to the proceedings or not. In very broad terms, where debt proceedings are brought against a company for a debt owing to a foreign lender of over €75,000 and the company does not enter an appearance to the proceedings, judgment may be obtained within six to nine months of the proceedings issuing. However, there is a Commercial Court in Ireland which can fast track commercial cases. Upon proceedings issuing, an application can be made to the Commercial Court for a case to be heard by it and, if a case is transferred to the Commercial Court for hearing, this will likely significantly reduce the time within which judgment would be obtained. There is no automatic entitlement for a case to be heard in the Commercial Court and, broadly speaking, the Commercial Court will only hear commercial disputes where the value of the claim is more than €1 million.

Enforcement of the judgment will depend on the assets which the company has in Ireland and there are a number of methods of enforcement. In relation to immoveable property/land, a foreign lender can register the judgment as a judgment mortgage over any property/land owned by the Irish company in Ireland following which it may be in a position to take the necessary steps to dispose of the property and use the proceeds of sale to discharge some or all of the debt. In relation to moveable property, an enforcement order can be obtained pursuant to which assets of the company may be seized. Furthermore, if it is believed that the Irish company is insolvent, a foreign lender who has obtained judgment can issue a statutory demand to the company calling on it to discharge the amount due pursuant to the judgment within 21 days failing which a petition can be brought to have the company wound up and have all assets liquidated to attempt to satisfy all creditors of the Irish company. The Irish courts will generally only order the winding up of the Irish company if it is satisfied that the Irish company is insolvent. It may take two to three months following the expiry of the 21-day demand letter for a liquidator to be appointed over the Irish company.

In terms of the time period for enforcing a foreign judgment, this will, as mentioned under question 7.2 above, depend on the jurisdiction in which the judgment has been made. Where the judgment has been given in an EU Member State, Brussels I applies and the judgment against the Irish company is essentially enforceable as if it were a judgment made by an Irish court meaning that the enforcement procedures, as described above, can be invoked.

In relation to judgments made by non-EU Member States, an application has to be made to the Irish courts before the judgment can be enforceable. Where the judgment has been given in a state which is a party to the Lugano Convention (being EU Member States, Iceland, Norway, and Switzerland), an application is made to have the foreign judgment declared enforceable in Ireland. It may take one to two months to have the foreign judgment declared enforceable, following which it can be enforced against a company as set out above. In relation to judgments from non-EU and non-Lugano Convention states, an application can be made to have the foreign judgment recognised in Ireland. However, unlike a judgment from a state which is a party to the Lugano convention, the application to have the judgment recognised is made on notice to the judgment debtor which brings with it practical issues such as serving the proceedings. Furthermore, the judgment debtor, being on notice of the application, may attend and oppose the application to have the judgment recognised. Therefore, whilst the application may get a first return date within one to three months from the date of issuing proceedings, the application may not proceed on the first return date if it is opposed, as the judgment debtor will be given the opportunity to challenge the application, and the foreign judgment holder could be significantly delayed in having the judgment recognised, depending on the extent of the challenge. Once the judgment has been declared enforceable or is recognised by the Irish courts, it can be enforced as set out above.

7.4 With respect to enforcing collateral security, are there any significant restrictions which may impact the timing and value of enforcement, such as (a) a requirement for a public auction, or (b) regulatory consents?

Generally no, the circumstances in which a lender can enforce its security under Irish law are largely dependent on the terms of the underlying security documents. The most common method of enforcement against a corporate lender is the appointment of a receiver or for the charge-holder to become mortgagee in possession of the charged property. S.439 of the Act provides that in selling property of a company, a receiver must exercise all reasonable care to obtain the best price reasonably obtainable for the property as at the time of sale. This may involve recourse to expert opinions and valuations of company property which, depending on the circumstances, could lead to a recommendation that a public auction is necessary in order to achieve the best available price for the respective property. This would have a consequent effect on the timing of any enforcement. The timing of enforcement could also be impacted by the appointment of an examiner (see question 7.6 below).

7.5 Do restrictions apply to foreign lenders in the event of (a) filing suit against a company in your jurisdiction, or (b) foreclosure on collateral security?

No, foreign lenders are subject to the same statutory limitation periods within which a claim must be brought and the same rules of court as those imposed on Irish lenders seeking to file suit against a company and enforce security through the courts.

7.6 Do the bankruptcy, reorganisation or similar laws in your jurisdiction provide for any kind of moratorium on enforcement of lender claims? If so, does the moratorium apply to the enforcement of collateral security?

Yes, Irish companies may enter examinership, which is a court-enforced moratorium on creditor action which allows a brief period during which a company can be restructured. This process usually results in creditor balances being reduced, while intangible assets of the company are protected, investment is obtained and the company can continue to trade. The examiner is typically appointed for 70 days (but this may be extended to 100 days or in exceptional cases, longer) during which time the lender will not be permitted to take any enforcement action against the security provider, save in respect of a security financial collateral arrangement as defined in the Financial Collateral Arrangement Regulations. Pursuant to the Insolvency Regulation, this moratorium is also ineffective in relation to rights *in rem* of creditors or third parties by way of security in assets situated outside of Ireland and does not affect the right of creditors to exercise their right of set-off against the claims of a debtor.

In addition to the above, there are certain other laws and codes that apply in the context of lending to natural persons and/or small- or medium-sized enterprises ("**SMEs**") (and the enforcement of such loans), many of which must be adhered to by foreign lenders lending into Ireland.

7.7 Will the courts in your jurisdiction recognise and enforce an arbitral award given against the company without re-examination of the merits?

Generally, yes – subject to certain conditions being satisfied. Ireland ratified the New York Arbitration Convention under s.24 of the Arbitration Act 2010. The Convention provides for the recognition and enforcement of domestic and international arbitral awards. Pursuant to s.23 of the Arbitration Act 2010, an award made by an arbitral tribunal under an arbitration agreement shall be enforceable in this jurisdiction either by action or leave of the High Court. For enforcement of foreign arbitral awards, the award must be in writing and be signed by the arbitrator or arbitrators. In arbitral proceedings with more than one arbitrator, the signatures of the majority of the tribunal will suffice, so long as the reason for any omitted signature is set out. The award should also state its date and the place of arbitration.

8 Bankruptcy Proceedings

8.1 How does a bankruptcy proceeding in respect of a company affect the ability of a lender to enforce its rights as a secured party over the collateral security?

The capacity of a lender to enforce its rights as a secured party over collateral security is not affected by liquidation proceedings entered into by a company. Should the enforcement of a security fail to discharge the total debt owed to the lender, the balance may be claimed in the liquidation process. However, the rights of a secured lender will be affected where the company has entered examinership proceedings, as discussed above.

8.2 Are there any preference periods, clawback rights or other preferential creditors' rights (e.g., tax debts, employees' claims) with respect to the security?

Yes. Pursuant to s.597 of the Act, a floating charge will be invalidated where it has been created within 12 months of the company entering into insolvency proceedings unless it is proven that the company was solvent immediately after the creation of the charge. This period will be extended to two years where the floating charge has been created in favour of a connected person.

The Act also provides for certain clawback rights where a fraudulent or unfair transfer of company property has occurred. For example, pursuant to s.604 of the Act, any transfer of company property to a creditor will be invalidated where such transfer was made with the view to securing a preference over other creditors in the company and was made within six months of the insolvency of the company (the period will be extended to two years where the transfer was made to a connected person).

With regard to preferential creditors, the expenses relating to an examinership or liquidation, together with certain taxes, rates and employee claims have priority over floating charge security holders.

8.3 Are there any entities that are excluded from bankruptcy proceedings and, if so, what is the applicable legislation?

All trading Irish companies and all ICAVs are subject to insolvency proceedings under the Act or the Irish Collective Asset-management Vehicles Act 2015 (as applicable).

8.4 Are there any processes other than court proceedings that are available to a creditor to seize the assets of a company in an enforcement?

Secured creditors may exercise set-off rights and appoint receivers without recourse to court proceedings. Unsecured creditors cannot seize secured assets of a company without a court order authorising such; however, unsecured creditors may be able to repossess goods/assets which have not been paid for in full by the company in question and which are subject to a valid retention of title clause.

9 Jurisdiction and Waiver of Immunity

9.1 Is a party's submission to a foreign jurisdiction legally binding and enforceable under the laws of your jurisdiction?

Generally, yes.

9.2 Is a party's waiver of sovereign immunity legally binding and enforceable under the laws of your jurisdiction?

Yes, Ireland accepts the recognised principles of international law as the rule of conduct in its relations with other States and accordingly, in principle, an Irish court will recognise a party's waiver of sovereign immunity.

10 Licensing

10.1 What are the licensing and other eligibility requirements in your jurisdiction for lenders to a company in your jurisdiction, if any? Are these licensing and eligibility requirements different for a "foreign" lender (i.e. a lender that is not located in your jurisdiction)? In connection with any such requirements, is a distinction made under the laws of your jurisdiction between a lender that is a bank *versus* a lender that is a non-bank? If there are such requirements in your jurisdiction, what are the consequences for a lender that has not satisfied such requirements but has nonetheless made a loan to a company in your jurisdiction? What are the licensing and other eligibility requirements in your jurisdiction for an agent under a syndicated facility for lenders to a company in your jurisdiction?

Until recently, commercial lending was not a regulated activity in Ireland and, unless the lender was a bank, there was generally no requirement to obtain a licence. However, the regulatory regime in Ireland has been the subject of significant debate in recent years leading, most recently, to the enactment of the Consumer Protection (Regulation of Credit Servicing) Act 2018. While not imposing any additional licensing requirements, this Act does require unregulated entities (other than securitisation special purpose vehicles which are exempt) that hold legal title to loans to Irish consumers or SMEs and/or control the overall strategy or key decisions relating to such loans to be authorised and regulated by the CBI.

In addition, lenders may also be subject to various other reporting and regulatory requirements, such as:

- the Credit Reporting Act 2013 requires that lenders – both regulated and unregulated – collect and report to the CBI certain information relating to credit advanced to non-consumer borrowers, which includes companies, limited liability partnerships, etc.; and
- lenders are typically required to comply with the CBI statistical reporting requirements.

Lenders (including unregulated lenders) providing certain services, which are already obliged to comply with Irish anti-money laundering and counter-terrorist financing obligations even though they are not authorised or licensed by the CBI, are required – unless they qualify for an exemption – to register with the CBI by virtue of new legislation passed to transpose the Fourth Anti-Money Laundering Directive into Irish law.

In addition, many lenders may find that they fall within the scope of regulation by virtue of other activities carried out by them, for example taking deposits. Any lender in Ireland which provides banking services, which includes the taking of deposits, is required, on application to the CBI, to obtain a licence from the European Central Bank. Carrying on a banking business in Ireland without a licence is a criminal offence. Banks licensed in another EU Member State may also be required to passport into Ireland in order to carry on a lending activity in Ireland that would otherwise be unregulated.

There are no specific licensing requirements that apply to a security agent under a syndicated facility. However, such an agent would be subject to regulation if it carries on any regulated activities; for example, accepting deposits. Any person or entity carrying on the business of a trustee of a trust or a "Company Service Provider" (as defined in the Criminal Justice (Money Laundering and Terrorist Financing) Act, 2010 (as amended)) may be required to obtain an authorisation to do so from the CBI (if it is a subsidiary of a credit or financial institution) or the Minister for Justice and Equality (in all other cases).

As regards the position of a foreign lender, if lending to persons in Ireland, they would generally be subject to the same conduct of business rules as an Irish lender, and are also required to hold the appropriate licence/authorisation if carrying on a regulated activity (albeit their regulatory status in their home country may have a bearing on the latter e.g. passporting rights if carrying on passportable activities).

11 Other Matters

11.1 Are there any other material considerations which should be taken into account by lenders when participating in financings in your jurisdiction?

Notwithstanding the measures referred to at question 10.1, the regulatory regime in Ireland relating to lending largely focuses on lending to natural persons and SMEs at present and there is various legislation, regulation and codes of which lenders would need to be cognisant if originating loans to such persons or to SMEs (or acquiring loans originated to such persons or to SMEs).

Acknowledgment

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Shiri Ish Shalom

1 Overview

1.1 What are the main trends/significant developments in the lending markets in your jurisdiction?

The total assets managed by institutional investors have grown rapidly over the last few years. Data from the Bank of Israel indicates that, as of April 2018, pension funds, provident funds and insurance companies manage assets of $454 billion, an increase of more than 250% over the past 10 years. In light of the high percentage of the provision for long-term savings in Israel (amongst the highest in the world), the growth of institutional assets is expected to continue rapidly.

The share of capital allocated by institutional investors to investment funds have grown at a steady pace over the last 10 years (from 1.8% in 2008 to 3.6% in 2017, at a growth rate of approximately 0.2% per year; the growth rate of direct loans provided by institutional lenders in 2018 was more moderate, although still high – 0.1%). In parallel to the steady growth of direct lending by institutional lenders, the bank corporate debt in Israel is continuously decreasing.

As indicated in the data above, alternative investments are consistently gaining traction as an asset class and institutional investors are key players in the Israeli syndicated loans market (syndicated loans issued in conjunction with institutional investors reached 70% in the year 2015 and have continued to grow over the last few years).

Although the role of institutional investors in the Israeli lending market is growing rapidly, alternative investments still have not grown to their full potential to serve as a material funding resource to the business sector. Thus, the share capital allocated by institutional investors to alternative investments in Israel – 5.3% of the total managed assets in 2017 – is still relatively low in comparison to North America and Europe, in which nearly 30% of the total managed assets were allocated to alternative investments. In addition, the size of the syndicated loan market in Israel is relatively low in comparison to other developed countries, in which the syndicated loan market provides credit similar in size to corporate bonds.

As institutional investors continue to increase their activity in the loan markets and as the relatively young hedge fund industry is growing rapidly, the size and role of the syndicated loan market in corporate financing is expected to increase significantly in the upcoming years.

1.2 What are some significant lending transactions that have taken place in your jurisdiction in recent years?

Significant syndicated lending transactions for 2017–2018 include:

(i) In 2017, the Jerusalem Municipality entered into a NIS 1 billion financing agreement with a consortium of three Israeli banks and two insurance funds for the construction of 1,000 new classrooms throughout the city of Jerusalem.

(ii) In 2018, Enlight Renewable Energy Ltd., which deals in solar and wind energy in Israel and Europe, signed an agreement with a consortium headed by Bank Hapoalim and two Israeli insurance funds for the financing of the Valley of Tears wind turbines farm project on the Golan Heights. The lending consortium will provide a non-recourse NIS 525 million loan, which will cover the construction period.

(iii) In 2018, the Greek energy company Energean signed a $1.275 billion financing deal for the development of Israel's Tanin and Karish offshore natural gas fields. The syndication is led by Bank Hapoalim, which will provide $375 million, and three foreign lenders will each provide $300 million – Morgan Stanley, Societe Generale and Natixis.

(iv) In 2018, Israel Power Management (IPM) power plant at Be'er Tuvia closed a NIS 1.6 billion financing transaction with Deutsche Bank and Israel's Bank Hapoalim for construction of the company's 450 megawatt combined cycle technology private power plant. Deutsche Bank led an international financing consortium that includes Credit Suisse, KFW, and other European banks and Bank Hapoalim led a consortium of local banks and institutional investors.

2 Guarantees

2.1 Can a company guarantee borrowings of one or more other members of its corporate group (see below for questions relating to fraudulent transfer/financial assistance)?

Yes, inter-company guaranties by parent and sister companies are common practice in Israel.

2.2 Are there enforceability or other concerns (such as director liability) if only a disproportionately small (or no) benefit to the guaranteeing/securing company can be shown?

While any board decision is subject to corporate governance issues and applicable law, there are no special enforceability, director liability or other concerns in connection with disproportionately small (or no) benefit to the guaranteeing/securing company.

2.3 Is lack of corporate power an issue?

While lack of corporate power may be an issue with respect to any corporate decision or action under applicable corporate law, there are no special concerns relating to inter-company guaranties. In any case, in order to mitigate corporate power concerns, lenders usually require appropriate legal opinions and/or representations, including confirmed board resolutions.

2.4 Are any governmental or other consents or filings, or other formalities (such as shareholder approval), required?

Generally, no.

2.5 Are net worth, solvency or similar limitations imposed on the amount of a guarantee?

No, they are not.

2.6 Are there any exchange control or similar obstacles to enforcement of a guarantee?

No, there are not.

3 Collateral Security

3.1 What types of collateral are available to secure lending obligations?

In Israel, all types of assets may serve as collateral to secure lending obligations. Mortgages, charges (fixed and floating), assignments, pledges and liens are common types of security in loan transactions.

3.2 Is it possible to give asset security by means of a general security agreement or is an agreement required in relation to each type of asset? Briefly, what is the procedure?

It is common practice in Israel to execute general security agreements, which govern the creation of security over the borrower's assets in order to secure its obligation towards the lender. Such agreement shall usually include an obligation by the borrower to create a fixed charge over ascertained and definite assets, a floating charge over changing assets, a mortgage over real estate property and the assignment of any rights and interest in contracts, bank accounts, receivables, etc. Each of the above types of security is governed by different laws, registration procedures, etc.

3.3 Can collateral security be taken over real property (land), plant, machinery and equipment? Briefly, what is the procedure?

Yes. Such security is usually created by way of mortgage in case of real property/land or fixed charge in case of a plant, machinery and equipment.

The mortgage or charge is created by an agreement between the debtor and the creditor. If the collateral is immovable property, the agreement must be in writing. A charge over an asset of a company must also be evidenced in writing.

A mortgage over land is filed with the Israeli Land Registry and Settlement of Rights. A charge over a company's plant, machinery or equipment is filed with the Israeli Companies Registry.

3.4 Can collateral security be taken over receivables? Briefly, what is the procedure? Are debtors required to be notified of the security?

Yes. This is usually done by way of assignment or floating charge. An assignment requires written notice to the relevant third-party debtor, while a floating charge requires due filing with the Israeli Companies Registry.

3.5 Can collateral security be taken over cash deposited in bank accounts? Briefly, what is the procedure?

Yes. Cash deposits can be taken as security by way of floating charge.

3.6 Can collateral security be taken over shares in companies incorporated in your jurisdiction? Are the shares in certificated form? Can such security validly be granted under a New York or English law governed document? Briefly, what is the procedure?

Yes, collateral security can be taken over shares.

Shares in Israel may be certificated. The share certificate, however, is not required to effect the security interest.

Share pledge/hypothec agreements may be governed by foreign law, provided that the registration requirements (including Hebrew forms) are complied with.

3.7 Can security be taken over inventory? Briefly, what is the procedure?

Yes, as a floating charge.

3.8 Can a company grant a security interest in order to secure its obligations (i) as a borrower under a credit facility, and (ii) as a guarantor of the obligations of other borrowers and/or guarantors of obligations under a credit facility (see below for questions relating to the giving of guarantees and financial assistance)?

Yes, it can.

3.9 What are the notarisation, registration, stamp duty and other fees (whether related to property value or otherwise) in relation to security over different types of assets?

Registration requirements differ pursuant to the type of assets secured (see questions 3.3–3.7 above).

There are no notarisation or stamp duty requirements in connection with the creation of security under Israeli law.

3.10 Do the filing, notification or registration requirements in relation to security over different types of assets involve a significant amount of time or expense?

Generally, no. There are prescribed forms for filing and the fees are generally minor. Note, however, that mortgages, foreign ownership and non-resident signatories may require translations and additional procedures and fees.

3.11 Are any regulatory or similar consents required with respect to the creation of security?

Generally, no.

3.12 If the borrowings to be secured are under a revolving credit facility, are there any special priority or other concerns?

Generally, no.

3.13 Are there particular documentary or execution requirements (notarisation, execution under power of attorney, counterparts, deeds)?

Yes, powers of attorney, deeds and certain execution procedures may be required.

4 Financial Assistance

4.1 Are there prohibitions or restrictions on the ability of a company to guarantee and/or give security to support borrowings incurred to finance or refinance the direct or indirect acquisition of: (a) shares of the company; (b) shares of any company which directly or indirectly owns shares in the company; or (c) shares in a sister subsidiary?

(a) Shares of the company

Under Israeli law, a company may purchase or guarantee the acquisition of its own shares. Where such actions are deemed "distribution of dividends", the company must comply with the limitations and restrictions that govern dividend distributions.

(b) Shares of any company which directly or indirectly owns shares in the company

See above.

(c) Shares in a sister subsidiary

See above.

5 Syndicated Lending/Agency/Trustee/Transfers

5.1 Will your jurisdiction recognise the role of an agent or trustee and allow the agent or trustee (rather than each lender acting separately) to enforce the loan documentation and collateral security and to apply the proceeds from the collateral to the claims of all the lenders?

Yes, it will.

5.2 If an agent or trustee is not recognised in your jurisdiction, is an alternative mechanism available to achieve the effect referred to above which would allow one party to enforce claims on behalf of all the lenders so that individual lenders do not need to enforce their security separately?

This is not applicable in Israel (see question 5.1 above).

5.3 Assume a loan is made to a company organised under the laws of your jurisdiction and guaranteed by a guarantor organised under the laws of your jurisdiction. If such loan is transferred by Lender A to Lender B, are there any special requirements necessary to make the loan and guarantee enforceable by Lender B?

Loans and guarantees can generally be assigned contractually.

6 Withholding, Stamp and Other Taxes; Notarial and Other Costs

6.1 Are there any requirements to deduct or withhold tax from (a) interest payable on loans made to domestic or foreign lenders, or (b) the proceeds of a claim under a guarantee or the proceeds of enforcing security?

Answer not available at this time.

6.2 What tax incentives or other incentives are provided preferentially to foreign lenders? What taxes apply to foreign lenders with respect to their loans, mortgages or other security documents, either for the purposes of effectiveness or registration?

Answer not available at this time.

6.3 Will any income of a foreign lender become taxable in your jurisdiction solely because of a loan to, or guarantee and/or grant of, security from a company in your jurisdiction?

Answer not available at this time.

6.4 Will there be any other significant costs which would be incurred by foreign lenders in the grant of such loan/guarantee/security, such as notarial fees, etc.?

Answer not available at this time.

6.5 Are there any adverse consequences for a company that is a borrower (such as under thin capitalisation principles) if some or all of the lenders are organised under the laws of a jurisdiction other than your own? Please disregard withholding tax concerns for purposes of this question.

Answer not available at this time.

7 Judicial Enforcement

7.1 Will the courts in your jurisdiction recognise a governing law in a contract that is the law of another jurisdiction (a "foreign governing law")? Will courts in your jurisdiction enforce a contract that has a foreign governing law?

The choice of foreign law to govern any contract will be recognised and upheld by the Israeli courts with respect to the contractual obligations therein, subject to any conflict with any mandatory provision of Israeli law.

7.2 Will the courts in your jurisdiction recognise and enforce a judgment given against a company in New York courts or English courts (a "foreign judgment") without re-examination of the merits of the case?

The recognition of foreign judgments in the State of Israel is governed by the Enforcement of Foreign Judgments Law 1958 (the "**Enforcement Law**"). Recognition of a foreign judgment under the Enforcement Law is available, but not automatic. The plaintiff would be required to have effected proper service of process on the respondent company. A foreign judgment can be enforced if (i) it satisfies the requirements and procedures of the Enforcement Law, and (ii) the defendant company is unable to demonstrate, to the satisfaction of the Court in Israel, that one or more of the defences to enforcement provided for under the Enforcement Law applies.

The Israeli courts would be required to be satisfied that: (a) the foreign judgment was obtained by a competent court having jurisdiction under the laws of the state and province in which the foreign judgment was obtained (the "**Foreign State**"); (b) the foreign judgment is final, conclusive and enforceable against the defendant company in the Foreign State; (c) the performance or observation of the foreign judgment is lawful, enforceable and not contrary to public policy under the laws of the State of Israel; and (d) the foreign judgment is a fully valid and enforceable judgment under the laws of the Foreign State.

The defendant company would have defences to the enforcement of the foreign judgment by the Israeli Courts, including for any one or more of the following reasons: (a) under the laws of the Foreign State, judgments given by Israeli competent courts are not enforceable in the Foreign State; (b) the rendering court in Foreign State did not have subject matter jurisdiction; (c) the judgment was the result of a fraud upon the Foreign State court; (d) the foreign judgment conflicts with another final and conclusive judgment still in effect between the same parties and regarding the same subject matter; (e) the foreign judgment may harm the sovereignty or security of Israel; or (f) the request for enforcement of the foreign judgment was submitted to the Israeli courts more than five years after the foreign judgment date, subject to certain exceptions determined in the Enforcement Law.

7.3 Assuming a company is in payment default under a loan agreement or a guarantee agreement and has no legal defence to payment, approximately how long would it take for a foreign lender to (a) assuming the answer to question 7.1 is yes, file a suit against the company in a court in your jurisdiction, obtain a judgment, and enforce the judgment against the assets of the company, and (b) assuming the answer to question 7.2 is yes, enforce a foreign judgment in a court in your jurisdiction against the assets of the company?

(a) If the suit pertains to a fixed sum deriving from a contract or undertaking evidenced in writing, it can be submitted in "summary procedure" ("fast-track" proceedings). Preparation of such claim varies pursuant to the complexity of the facts giving rise thereto, and can be filed immediately after its preparation. If the defaulting company does not submit a request for defence within 30 days of receipt of the claim, the plaintiff is entitled to obtain a judgment in his favour from the court. The length of time for obtaining such judgment (days/months) is influe.nced by the complexity of the case and the workload of the relevant court. Enforcement of the judgment against the assets of the company may require proceedings before the Law Enforcement and Collection Authority and their length will vary pursuant to the type of assets which are the subject matter of the enforcement proceedings.

(b) Whereas recognition of a foreign judgment under the Israeli Enforcement Law is not automatic (see the answer to question 7.2 above), the length of proceedings for such enforcement varies according to the complexity of the case and claims raised by both parties pursuant to the Enforcement Law. The length of such proceeding is also influenced by the workload of the relevant hearing court and may take several months or even years.

7.4 With respect to enforcing collateral security, are there any significant restrictions which may impact the timing and value of enforcement, such as (a) a requirement for a public auction, or (b) regulatory consents?

While enforcement may be subject to restrictions, timing issues and regulatory requirements or consents deriving from the type of security, there are no special restrictions or regulatory requirements related directly to enforcement of collateral security.

7.5 Do restrictions apply to foreign lenders in the event of (a) filing suit against a company in your jurisdiction, or (b) foreclosure on collateral security?

No, foreign lenders have the same status as domestic lenders in connection with filing a suit against an Israeli company or foreclosure on collateral security.

7.6 Do the bankruptcy, reorganisation or similar laws in your jurisdiction provide for any kind of moratorium on enforcement of lender claims? If so, does the moratorium apply to the enforcement of collateral security?

Yes, a moratorium may apply to lenders' claims and security enforcement during bankruptcy or reorganisation proceedings.

7.7 Will the courts in your jurisdiction recognise and enforce an arbitral award given against the company without re-examination of the merits?

Under the Israeli Arbitration Act, parties may request the courts to approve an arbitral award, thereby giving such award the effect of a court ruling.

The Arbitration Act provides for two methods to contest an arbitration award before the courts: (1) request for annulment of the award on the grounds of specific causes set forth in the Arbitration Act, such as an award outside the jurisdiction of the arbitrator, unlawful appointment of the arbitrator or bias of the arbitrator; and (2) submission of an appeal, provided, however, that such right was granted and agreed in advance between the parties in the arbitration agreement executed thereby.

When reviewing an annulment request, the courts will not re-examine the merits of the arbitration award, and their review shall be limited to determining compliance with basic procedural requirements pursuant to parameters and causes defined in the Arbitration Act.

In appeal proceedings, the arbitration award may be re-examined by the court on its merits.

8 Bankruptcy Proceedings

8.1 How does a bankruptcy proceeding in respect of a company affect the ability of a lender to enforce its rights as a secured party over the collateral security?

As noted above, security may be subject to moratorium during bankruptcy proceedings, unless the bankruptcy Court expressly approves enforcement.

8.2 Are there any preference periods, clawback rights or other preferential creditors' rights (e.g., tax debts, employees' claims) with respect to the security?

Yes, there are.

8.3 Are there any entities that are excluded from bankruptcy proceedings and, if so, what is the applicable legislation?

No, there are not.

8.4 Are there any processes other than court proceedings that are available to a creditor to seize the assets of a company in an enforcement?

Creditors may apply to the Law Enforcement and Collection System Authority (an administrative authority primarily authorised to execute court judgments).

9 Jurisdiction and Waiver of Immunity

9.1 Is a party's submission to a foreign jurisdiction legally binding and enforceable under the laws of your jurisdiction?

Generally, yes, subject to international law principles and excluding a limited number of foreign jurisdictions such as Iran and Syria.

9.2 Is a party's waiver of sovereign immunity legally binding and enforceable under the laws of your jurisdiction?

Generally, yes, save for specific matters protected under international law (e.g. diplomatic immunity).

10 Licensing

10.1 What are the licensing and other eligibility requirements in your jurisdiction for lenders to a company in your jurisdiction, if any? Are these licensing and eligibility requirements different for a "foreign" lender (i.e. a lender that is not located in your jurisdiction)? In connection with any such requirements, is a distinction made under the laws of your jurisdiction between a lender that is a bank versus a lender that is a non-bank? If there are such requirements in your jurisdiction, what are the consequences for a lender that has not satisfied such requirements but has nonetheless made a loan to a company in your jurisdiction? What are the licensing and other eligibility requirements in your jurisdiction for an agent under a syndicated facility for lenders to a company in your jurisdiction?

There are no licensing and other eligibility requirements in Israel for local or foreign lenders to a company. There are also no licensing and other eligibility requirements in Israel for an agent under a syndicated facility. Note, however, that certain regulatory requirements or restrictions may apply to certain types of lenders/agents (such as banks and mutual funds, etc.).

11 Other Matters

11.1 Are there any other material considerations which should be taken into account by lenders when participating in financings in your jurisdiction?

The introduction of the LSTA – Loan Syndications and Trading Association and its documentation is certainly the most important development in Israel's corporate loan syndication market. While local market participants and law firm still use various forms of documentation that often include certain LMA provisions and provide for limited liquidity, we are proud to work with the LSTA on a set of secondary market documents drafted for the Israeli Market with liquidity in mind. In light of the well-recognised importance of liquidity in functioning financial markets, the development of the secondary loan market as a liquid asset class constitutes a mutual goal for investors, companies and financing institutions. The LSTA introduced its documents in March in a seminar at the TLV Hilton Hotel and plans to publish and post initial secondary market documentation on the LSTA website by end of Q1 2019. We believe that the Israel LSTA documents will be widely adopted and will have a significant impact on Israel's corporate loan market and its liquidity in the near future.

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LAW OFFICE

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E. Schaffer & Co. is the only firm in Israel to join the LSTA and its Israel and U.S.-trained Banking & Finance team has gained unparalleled expertise serving as lead counsel for banks and financial institutions in complex cross-border financing transactions, including syndicated loans origination and trading, secured lending, debt and collateral assignments, inter-creditor agreements, refinancing transactions, ISDA and derivatives, factoring and complex financial instruments.

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Italy

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1 Overview

1.1 What are the main trends/significant developments in the lending markets in your jurisdiction?

With a view to increasing the competitiveness of the Italian lending market during the credit crunch, a number of laws have been introduced by the Italian legislator in recent years. In particular:

- new players have been given access to the lending market by including them among the entities licensed to lend directly to Italian entities (for further details, see Section 10);
- non-listed companies have been given access to bond financings; and
- the tax regime has been rendered more favourable by extending the application of certain tax benefits (*i.e.* the exemption from withholding tax over interest and the substitutive tax regime).

Furthermore, new and more flexible types of *in rem* security interests have been introduced into the Italian legal system:

- the non-possessory pledge over movable assets (for further details, see question 3.7); and
- the security transfer of real property (*patto marciano*) (for further details, see question 3.3).

Moreover, an organic reform to the Italian bankruptcy law has been recently adopted by the Italian Government (after consultation with the Parliamentary Committees) and is expected to come into force (with potential minor amendments) by the end of 2019/beginning of 2020. The main features of the reform include, *inter alia*: (i) the introduction of the notion of group insolvency; (ii) an "early warning" system aimed at anticipating and preventing the occurrence of insolvency situations; (iii) several amendments to the rules governing composition agreement with creditors (*concordato preventivo*), debt restructuring agreements (*accordo di ristrutturazione*) and judicial liquidation proceedings (previously *fallimento*); and, more generally, (iv) the introduction of a coherent and uniform legislative framework of insolvency in Italy. Until the prospected reform enters into force, the current provisions of the Italian bankruptcy law still continue to apply (for further details, see Section 8).

Finally, the Italian lending market is expected to be affected by the outcome of Brexit. In the event of a hard Brexit, banks established in the UK may be treated as foreign (non-EU) banks, and, consequently, automatically lose their European passport. As a result, the principle of freedom to provide services and the principle of freedom of establishment would no longer apply to them. Most UK banks will use subsidiaries established within the EU (to which certain assets will be transferred) to engage in lending transactions in Italy (and in the rest of the EU).

1.2 What are some significant lending transactions that have taken place in your jurisdiction in recent years?

A EUR 1.7bn term facility granted by a pool of banks comprising, among others, Banca IMI, Crédit Agricole, Goldman Sachs International, Intesa Sanpaolo and Mediobanca (advised by Allen & Overy) to Prysmian Group S.p.A. for its acquisition of General Cable Corporation.

A financing granted to Playtech (a leading listed company in the gambling industry assisted by Allen & Overy) for its acquisition of a 70% stake in the share capital of Italian betting company Snaitech from Global Games and OI Games, for an estimated value of EUR 846m. Playtech subsequently made a mandatory takeover offer for all the remaining shares in Snaitech.

A new EUR 5bn revolving credit facility granted by a pool of banks (advised by Allen & Overy) to Italian telecommunications company TIM.

A financing granted to EG Group (a leading petrol forecourt retail convenience operator advised by Allen & Overy) for the acquisition of the going concern consisting of approximately 1,200 Esso-branded service stations located throughout Italy from Esso Italiana, the ExxonMobil Group Italian holding company. The acquisition financing for the Italian assets, enabling EG Group to enter the Italian market, was part of the wider financing granted to EG Group for its acquisition of Exxon Mobil Group retail assets in other countries, including Germany.

A EUR 3.5bn seven-year financing granted by a pool of banks, the European Investment Bank and Cassa Depositi e Prestiti to Open Fiber to help fund the development of its ultrafast broadband network across Italy. The deal is the largest ever financing for a fibre optic network in the EMEA region.

A new EUR 1.75bn five-year credit facility granted to Atlantia to refinance the bridge loan obtained in May 2018 to finance Atlantia's acquisition of investments in Abertis and Hochtief. On the same date, Atlantia obtained a five-year revolving credit facility of EUR 1.250bn for general corporate purposes.

2 Guarantees

2.1 Can a company guarantee borrowings of one or more other members of its corporate group (see below for questions relating to fraudulent transfer/financial assistance)?

An Italian company can guarantee borrowings of one or more other members of its corporate group subject to certain limits. See questions 2.2, 2.5 and Section 4 for further details.

2.2 Are there enforceability or other concerns (such as director liability) if only a disproportionately small (or no) benefit to the guaranteeing/securing company can be shown?

In order for an Italian company to grant a guarantee or security, there must be a corporate benefit. Whilst corporate benefit for a downstream guarantee or security is usually self-evident, the validity and effectiveness of an upstream or cross-stream guarantee or security granted by an Italian company depends on the existence of an actual benefit as direct or indirect "consideration" for entering into the guarantee or security.

Undervalue guarantees or security may be a breach of the directors' duties to act in the interests of the company, which can sometimes render them personally liable. The "business judgement" rule is strict and the risk of director liability can be high. Common directorships (conflicts of interest) increase risk – arrange for independent boards, if possible. Guarantees by companies whose directors have an interest in the guaranteed or secured company have increased risk.

Italian law does not, except for certain limited and specific purposes (such as antitrust law), recognise the concept of the "group" or "group interest" and, therefore, the group interest in a transaction is not a sufficient ground to exclude the application of the *ultra vires doctrine*.

Articles 2497 *et seq*. of the Italian civil code set out the general rules applying to any entity which, by virtue of a controlling or similar relationship (not necessarily granted by a majority stake), exercises the activity of direction and coordination (*attività di direzione e coordinamento*) over the companies in its group. In particular, article 2497 provides that if the holding company, in the exercise of the activity of direction and coordination, breaches the principles of the correct corporate and entrepreneurial management in order to pursue its own interest (or the interest of a third party), it is directly liable *vis-à-vis* the shareholders of the subsidiary for compromising the profitability of the subsidiary, as well as towards the subsidiary's creditors for having put at risk the integrity of the share capital of the subsidiary. In the case of bankruptcy of the subsidiary, the action pertaining to the creditors against the holding company may be exercised by the insolvency receiver of the bankrupt subsidiary.

2.3 Is lack of corporate power an issue?

According to articles 2384 and 2475-*bis* of the Italian civil code, lack of corporate power deriving from the by-laws or a corporate resolution of a joint stock company or limited liability company, as well as the existence of a director's personal or a third party's interest in a transaction, cannot be raised against a counterparty unless it proves that the counterparty has acted for the purpose of damaging the company.

2.4 Are any governmental or other consents or filings, or other formalities (such as shareholder approval), required?

The granting of a guarantee must be permitted under the by-laws of the company. Management bodies' and shareholders' resolutions may be required, in accordance with the by-laws.

The granting of guarantees *vis-à-vis* the public is considered a form of lending and, as a consequence, it is an activity that can be carried out exclusively by entities licensed to carry out lending activities in Italy. For further details, see Section 10.

2.5 Are net worth, solvency or similar limitations imposed on the amount of a guarantee?

The most relevant limits on the amount of a guarantee that can be issued are:

- limits arising from financial assistance provisions. For further details, see Section 4;
- limits arising from corporate benefit rules. For further details, see question 2.2 above; and
- pursuant to Article 1938 of the Italian civil code, the guarantor may only guarantee future obligations if an overall maximum guaranteed amount is set.

2.6 Are there any exchange control or similar obstacles to enforcement of a guarantee?

Under Italian law, there are no exchange control or similar restrictions to the enforcement of a guarantee.

3 Collateral Security

3.1 What types of collateral are available to secure lending obligations?

The forms of collateral mainly used in Italian financing transactions are the following:

- Mortgage over real property, ships or aircraft.
- Security transfer of real property (*patto marciano*).
- Special privilege over certain movable assets.
- Pledge over a private company's shares.
- Pledge over marketable securities.
- Pledge or assignment by way of security of receivables.
- Pledge over bank accounts.
- Pledge over intellectual property.
- Pledge over goods.
- Non-possessory pledge over movable assets (subject to the implementation of the relevant register).

3.2 Is it possible to give asset security by means of a general security agreement or is an agreement required in relation to each type of asset? Briefly, what is the procedure?

Italian law does not provide for a universal corporate security interest covering all existing and future assets generically. But most common assets can be the subject of separate security.

3.3 Can collateral security be taken over real property (land), plant, machinery and equipment? Briefly, what is the procedure?

Real property mortgage

The mortgage deed must be signed before an Italian notary and the mortgaged property must be specified in detail. After-acquired property, including unplanned buildings, must be mortgaged when acquired. The deed should be registered in the local land registry to be enforceable against third parties (renewable after 20 years). Priority ranks from the date and time of registration. There is no advance priority reservation.

Security transfer of immovable property (*patto marciano*)

A loan granted to an entrepreneur by a bank, or another entity authorised to grant loans to the public in Italy, may be secured by transferring to the creditor (or to a company in the creditor's group authorised to purchase, hold, manage and transfer rights *in rem* in immovable properties), the ownership of a property or of another immovable right of the entrepreneur or of a third party. The transfer is subject to the condition precedent of the debtor defaulting.

Special privilege over certain movable assets

The special privilege deed must be signed before an Italian notary and can only be granted by the debtor to secure facilities with an overall maturity longer than 18 months granted to it by Italian or other EU banks.

The special privilege may cover: (a) existing and future equipment, concessions and produced goods of the enterprise; (b) raw materials, semi-manufactured goods, stock, finished goods, fruit, livestock and goods; (c) goods purchased with the loan in respect of which the special privilege is intended to be granted; and (d) present or future receivables arising from the sale of the assets and goods listed in (a) to (c).

For validity against creditors, the special privilege must be registered in the special register kept at the competent local court.

3.4 Can collateral security be taken over receivables? Briefly, what is the procedure? Are debtors required to be notified of the security?

Present and future receivables arising under an existing contract can be pledged or assigned.

Special rules apply to receivables against public authorities.

The deed of assignment of receivables arising out of rental leases having a remaining term exceeding three years must be executed in front of an Italian notary and registered.

Receivables arising under future contracts must be pledged/assigned upon their coming into existence. See Section 2 for the implications.

The deed of pledge must be in written form.

Formalities for rendering the pledge/assignment enforceable against third-party creditors of the pledgor/assignor (including a receiver in the pledgor/assignor's insolvency) are either a notice of the assignment to, or an express acknowledgement by, the obligor, in each case bearing a date certain at law (*data certa*) pursuant to Italian law.

3.5 Can collateral security be taken over cash deposited in bank accounts? Briefly, what is the procedure?

A pledge can be granted over cash deposited in bank accounts. For the perfection formalities see question 3.4. New formalities must be put in place every time the account balance changes. There is a risk – also for claw-back purposes – that the pledge purported to be created over each increase in the balance of the relevant account may not exist until the above formalities are carried out and that each pledge should be considered a new and different pledge for all intents and purposes. See Section 2 for the implications. Any utilisation of the money standing to the credit of a pledge account will likely amount to a release of the relevant sum from the security interest.

3.6 Can collateral security be taken over shares in companies incorporated in your jurisdiction? Are the shares in certificated form? Can such security validly be granted under a New York or English law governed document? Briefly, what is the procedure?

Pledge over shares of a *società per azioni*

The deed of pledge can be non-notarial but must bear a certain date. The pledge must be: (i) registered on the certificates representing the shares – whether by endorsement (*girata*) performed by the pledgor or by annotation performed by a director of the issuing company; and (ii) annotated in the shareholders' book of the company for enforceability against, respectively, the creditors and the issuing company. The creditor (directly or through a depository) must take possession of the pledged share certificates.

The pledge can cover distributions, new issues of shares and exchanges. The creditor can (and typically does) authorise the debtor to exercise voting rights and collect distributions until the occurrence of a default. Where the creditor has voting rights, consider consolidation, loss of group tax relief, etc.

The market seems to tolerate the practice of granting security on Italian shares by a foreign law-governed document; however, for the principle of *lex rei sitae*, the pledged shares must be transferred to the country of applicable law. Please also take into account the perfection formalities required.

Pledge over quotas of a *società a responsabilità limitata*

The quotas are not represented by certificates. The deed of pledge must be in notarial form and should be registered with the companies register in order for the pledge to be enforceable against third parties. Significant tax implications arise in connection with such registration (for further details, see question 6.4).

The pledge must be annotated in the quotaholders' book of the company in order to be enforceable against the issuing company.

3.7 Can security be taken over inventory? Briefly, what is the procedure?

Pledge over goods with dispossession

The deed of pledge can be non-notarial but must bear a certain date. This can cover present movable and unregistered assets of the company. Future assets must be separately pledged under new security. See Section 2 for the implications. A right of substitution of the pledged assets may be provided, subject to the value of the replacing goods not exceeding the value of the replaced ones. As from the date of perfection of the pledge, the goods are not available to the pledgor without the cooperation of the secured creditor. The goods must at all times be identifiable.

Special rules apply if the assets are deposited with a *magazzino generale*.

Non-possessory pledge over movable assets

At the present date, it is not possible to create such a pledge since the relevant electronic register set up by the Italian tax authority (*Agenzia delle Entrate*) has not been created. Once this is available, the non-possessory pledge may be established:

- to secure financings, whether present or future, granted in order to run the business. A maximum secured amount must be set;
- over unregistered movable assets (including receivables and other immaterial assets), whether existing or future and whether determined or determinable, also by making reference to one or more categories of products or to an overall value; and

- by entry on the aforesaid electronic register. From the date of registration, the pledge acquires its ranking and is enforceable against third parties and in insolvency proceedings. The entry lasts for 10 years and is renewable before expiry.

The pledged assets can be transformed or sold. The pledge is automatically transferred onto the product resulting from the transformation, the consideration deriving from the sale or the substitute asset purchased with that consideration, as applicable, without giving rise to the creation of new security.

3.8 Can a company grant a security interest in order to secure its obligations (i) as a borrower under a credit facility, and (ii) as a guarantor of the obligations of other borrowers and/or guarantors of obligations under a credit facility (see below for questions relating to the giving of guarantees and financial assistance)?

Yes. For limitations, see questions 2.2, 2.5 and Section 4.

3.9 What are the notarisation, registration, stamp duty and other fees (whether related to property value or otherwise) in relation to security over different types of assets?

Excluding taxes (in this respect see Section 6), the fees that could arise in relation to securities relate to the following:

- Notarisation may be necessary for the validity and enforceability of a security agreement (*e.g.* real property mortgages) or to certify the date of the security agreement.
- Stamp duties apply to security agreements which are subject to registration. Stamp duties are based on the number of pages of a security document and are generally not material.

3.10 Do the filing, notification or registration requirements in relation to security over different types of assets involve a significant amount of time or expense?

Yes, depending on the type of security. However, certain security must be registered in Italy for perfection purposes. In such cases, Italian registration taxes will apply.

3.11 Are any regulatory or similar consents required with respect to the creation of security?

In general, no consent is required. However, the consent to the assignment of receivables against public authorities may be required.

3.12 If the borrowings to be secured are under a revolving credit facility, are there any special priority or other concerns?

No, there are not.

3.13 Are there particular documentary or execution requirements (notarisation, execution under power of attorney, counterparts, deeds)?

Certain security documents must be executed in notarial form. For notarial security documents, the parties should provide evidence of their signatory powers.

4 Financial Assistance

4.1 Are there prohibitions or restrictions on the ability of a company to guarantee and/or give security to support borrowings incurred to finance or refinance the direct or indirect acquisition of: (a) shares of the company; (b) shares of any company which directly or indirectly owns shares in the company; or (c) shares in a sister subsidiary?

(a) Shares of the company

An Italian company, whether an S.p.A. or S.r.l., is prohibited from providing financial assistance (i.e. granting a loan or providing a guarantee or security) to any entity for financing or refinancing the direct or indirect acquisition or subscription of its own shares. Whitewash for S.p.A. is allowed under certain conditions.

Various structures have been implemented in order to mitigate the impact of the financial assistance prohibition. The most frequently used structure involves the merger of the target company into the acquisition vehicle after closing. However, any risk of voidness must be assessed on a case-by-case basis by looking at the transaction as a whole.

(b) Shares of any company which directly or indirectly owns shares in the company

The same rules described in sub paragraph (a) above apply.

(c) Shares in a sister subsidiary

In principle, there are no restrictions with respect to security or guarantees granted over shares in a sister subsidiary (subject, in any case, to the corporate benefit analysis). However, any risk of voidness must be assessed on a case-by-case basis by looking at the transaction as a whole.

5 Syndicated Lending/Agency/Trustee/Transfers

5.1 Will your jurisdiction recognise the role of an agent or trustee and allow the agent or trustee (rather than each lender acting separately) to enforce the loan documentation and collateral security and to apply the proceeds from the collateral to the claims of all the lenders?

Security must be granted to, and perfected in favour of, each creditor individually. Trusteeship and parallel debt arrangements are generally not recognised in Italy. In syndicated loans, secured creditors appoint an agent on the basis of a mandate (*mandato con rappresentanza*). The agent is entitled to exercise the secured creditors' rights and to enforce the security on the basis of the intercreditor arrangements. However, each secured creditor should intervene in the judicial enforcement.

5.2 If an agent or trustee is not recognised in your jurisdiction, is an alternative mechanism available to achieve the effect referred to above which would allow one party to enforce claims on behalf of all the lenders so that individual lenders do not need to enforce their security separately?

See question 5.1.

5.3 Assume a loan is made to a company organised under the laws of your jurisdiction and guaranteed by a guarantor organised under the laws of your jurisdiction. If such loan is transferred by Lender A to Lender B, are there any special requirements necessary to make the loan and guarantee enforceable by Lender B?

Perfection requirements change depending on whether the transfer made by Lender A to Lender B is by transfer of contract (*cessione di contratto*) or assignment of receivables (*cessione del credito*).

A transfer of contract requires the consent of all parties, including the assigned debtor and guarantor. This can be provided ahead of the assignment, by including an express consent in the relevant loan agreement or guarantee, as applicable.

An assignment of receivables:

- does not require the consent of the assigned debtor and guarantor, unless the loan agreement or the guarantee, as applicable, expressly prohibits the assignment of the receivables arising therefrom; and
- must be notified to the debtor and the guarantor, as applicable, or accepted by it.

In order for the assignment to be enforceable against third parties, the notice or acceptance must bear a date certain at law pursuant to Italian law.

If the loan is secured, perfection formalities will need to be carried out in order to render the transfer of such security interest enforceable against third parties. However, if the assignment of the loan is carried out pursuant to article 58 of Legislative Decree No. 385 of 1 September 1993 (the "Italian Banking Act") or to an Italian securitisation vehicle pursuant to Law No. 130/1999 (the "Italian Securitisation Law"), no perfection formalities need to be carried out.

Should the receivables be governed by a law other than Italian law, the provisions of Article 14 of Council Regulation (EC) No. 593/2008 of 17 June 2008 on the Law Applicable to Contractual Obligations (the "Rome I Regulation") will apply, pursuant to which such law will govern the assignability of the receivables and the rights and obligations between the assignee and the assigned debtors (including the enforceability of the assignment against the assigned debtors).

6 Withholding, Stamp and Other Taxes; Notarial and Other Costs

6.1 Are there any requirements to deduct or withhold tax from (a) interest payable on loans made to domestic or foreign lenders, or (b) the proceeds of a claim under a guarantee or the proceeds of enforcing security?

As a general rule, no withholding tax is chargeable on interest payable on loans made to resident lenders. A withholding tax (generally at the rate of 26%) is chargeable on interest payable to a non-Italian resident lender (unless it is lending through an Italian branch to which the loan is effectively connected). The withholding tax can be reduced under the provisions of the double tax treaty applicable between Italy and the country of residence of the beneficial owner of the interest.

Moreover, no withholding tax applies to interest paid by Italian entrepreneurs on medium/long-term loans if extended, *inter alia*, by credit institutions established in the EU and institutional investors subject to regulatory supervision established in countries that allow an adequate exchange of information with Italy.

In case of proceeds of a claim under a guarantee or proceeds of enforcing security, in accordance with one interpretation of Italian tax law, any such payment would be equal to the payment under the loan and therefore may be subject to the same withholding tax.

6.2 What tax incentives or other incentives are provided preferentially to foreign lenders? What taxes apply to foreign lenders with respect to their loans, mortgages or other security documents, either for the purposes of effectiveness or registration?

Substantial registration taxes, depending on the nature of the security and the features of the facility agreement, may apply. In certain cases, a substitutive tax regime (the **Substitutive Tax**) may be applicable in order to reduce the indirect taxes ordinarily applicable to the loan and the security package (e.g. registration and mortgage taxes).

The Substitutive Tax (generally at the rate of 0.25%) applies, upon the option of the parties, if the loan: (i) is granted, *inter alia*, by Italian banks (including Italian permanent establishments of EU and non-EU banks), EU banks, Italian securitisation companies and EU collective investment funds; (ii) is entered into within the territory of Italy; and (iii) has a duration exceeding 18 months.

Where Substitutive Tax does not apply, the securities are subject to indirect taxes varying from EUR 200 (where the guarantor is securing its own obligations) to 0.5% (where third parties' obligations are being secured) while mortgage tax is generally levied at a 2% rate on real estate mortgages.

Registration taxes may not be payable if the security agreement is executed outside Italy (unless specific events occur, *e.g.* case of use, explicit reference or voluntary registration). However, certain security must be registered in Italy for perfection purposes, *e.g.* real estate mortgages, special privileges (certain movables), pledges of quotas of an S.r.l., pledges of intellectual property and mortgages of ships and aircraft. In particular, the granting of a pledge over quotas of an S.r.l. attracts registration tax equal to 0.5% of the amount of the secured obligations where third parties' obligations are being secured.

6.3 Will any income of a foreign lender become taxable in your jurisdiction solely because of a loan to, or guarantee and/or grant of, security from a company in your jurisdiction?

Generally, a foreign lender granting a loan to an Italian resident entity does not meet the concept of permanent establishment and therefore the lender remains a taxpayer not resident in Italy for fiscal purposes.

Please see question 6.1 above for the withholding tax treatment of interest paid by an Italian resident entity to foreign lenders.

6.4 Will there be any other significant costs which would be incurred by foreign lenders in the grant of such loan/guarantee/security, such as notarial fees, etc.?

Notarisation may be necessary for the validity of certain security agreements (*e.g.* real property mortgages) or to certify the date of the security agreement. Notarial fees can be material, especially in case of real property mortgages, although they are generally negotiable with the public notary.

6.5 Are there any adverse consequences for a company that is a borrower (such as under thin capitalisation principles) if some or all of the lenders are organised under the laws of a jurisdiction other than your own? Please disregard withholding tax concerns for purposes of this question.

Starting from 2016, no specific adverse consequences are provided by Italian law in case of loans extended by foreign lenders (until 2015, a specific black list costs regime was applicable).

7 Judicial Enforcement

7.1 Will the courts in your jurisdiction recognise a governing law in a contract that is the law of another jurisdiction (a "foreign governing law")? Will courts in your jurisdiction enforce a contract that has a foreign governing law?

According to article 3 of the Rome I Regulation on the law applicable to contractual obligations, the parties to an agreement are generally free to choose the law governing the agreement.

However, pursuant to article 3.3 of the Rome I Regulation, if a contract is in breach of Italian public policy (*ordine pubblico*) or mandatory rules (*norme di applicazione necessaria*), Italian Courts will not enforce such agreement.

7.2 Will the courts in your jurisdiction recognise and enforce a judgment given against a company in New York courts or English courts (a "foreign judgment") without re-examination of the merits of the case?

European countries

In particular, article 36 of EU Regulation No. 1215/2012 (the "Recast Brussels Regulation") provides that a judgment issued by the court of an EU Member State shall be recognised in the other Member States "without any special procedure being required". While the UK is still part of the European Union, the Recast Brussels Regulation continues to apply, whereas, in case of a hard Brexit, it will cease to apply to it.

Non-European countries (*e.g.* New York)

The acknowledgment and enforcement of decisions issued by courts belonging to jurisdictions outside of the European Union is generally governed by Law No. 218 of 31 May 1995. The enforcement of a foreign decision in the Italian territory requires the filing of a petition before the Court of Appeal of the place where the enforcement shall then take place. Such proceedings usually last six months to one year, and the order authorising the enforcement of the foreign decision in Italy fully entitles the creditor to seek enforcement over the debtor's assets.

7.3 Assuming a company is in payment default under a loan agreement or a guarantee agreement and has no legal defence to payment, approximately how long would it take for a foreign lender to (a) assuming the answer to question 7.1 is yes, file a suit against the company in a court in your jurisdiction, obtain a judgment, and enforce the judgment against the assets of the company, and (b) assuming the answer to question 7.2 is yes, enforce a foreign judgment in a court in your jurisdiction against the assets of the company?

The average length of first instance proceedings in Italy is approximately four years. Although a judgment issued at the end of first instance proceedings is normally enforceable, it would take approximately 10 years to obtain a final and binding judgment (due to appeals, the complexity of the case at stake or a court with a busy docket).

The Recast Brussels Regulation, in the absence of any contestation raised by the defendant, should theoretically speed up the proceedings aimed at the recognition and enforcement of a judgment granted in a Member State. On the contrary, the so-called acknowledgment proceedings of a judgment granted in a non-European country usually last one year to one-and-a-half years, depending on the agenda of the Court and issues relating to the complexity of the case at stake.

Enforcement proceedings last approximately three to four years and the duration is largely linked to the specific type of assets foreclosed by the creditor.

7.4 With respect to enforcing collateral security, are there any significant restrictions which may impact the timing and value of enforcement, such as (a) a requirement for a public auction, or (b) regulatory consents?

The enforcement of collateral security normally depends on the nature of the secured assets as well as on the ranking of the security itself. In particular, a security interest may be enforced:

- by means of a forced sale of the charged assets;
- for certain assets by means of a private sale, if so agreed by the parties in the original security agreement or at any time thereafter (pre- or post-default);
- through a public notary, a lawyer or an accountant, in certain stages of the enforcement proceeding; or
- in the case of marketable securities with an available market value, by an authorised broker on the market.

Financial collateral created under Legislative Decree No. 170 of 21 May 2004 (the "Financial Collateral Decree", which has implemented the financial collateral directive in Italy) may be enforced by appropriation or private sale.

7.5 Do restrictions apply to foreign lenders in the event of (a) filing suit against a company in your jurisdiction, or (b) foreclosure on collateral security?

Generally no restrictions apply for foreign lenders.

7.6 Do the bankruptcy, reorganisation or similar laws in your jurisdiction provide for any kind of moratorium on enforcement of lender claims? If so, does the moratorium apply to the enforcement of collateral security?

The bankruptcy of the debtor, as well as its submission to reorganisation proceedings (*i.e. concordato preventivo*, *accordi di ristrutturazione*, *pre-concordato* and *concordato preventivo con continuità aziendale*), affect the secured creditor's right to enforce the security. Upon the commencement of such proceedings, and subject to certain exceptions (see question 8.1), all the enforcement actions made by creditors are stayed and creditors must file a claim within a defined period.

7.7 Will the courts in your jurisdiction recognise and enforce an arbitral award given against the company without re-examination of the merits?

Italy is party to the 1958 New York Convention, which establishes the conditions under which arbitral awards can be recognised and enforced within the contracting states.

An Italian Court will declare the effectiveness of arbitral awards *inaudita altera parte* provided that: (i) the litigation falls within the scope of the arbitration agreement pursuant to Italian law; and (ii) the contents of the arbitral award comply with Italian public policy. The counterparty is entitled to challenge such decision before the competent Court of Appeal within 30 days from its notification.

8 Bankruptcy Proceedings

8.1 How does a bankruptcy proceeding in respect of a company affect the ability of a lender to enforce its rights as a secured party over the collateral security?

Upon the declaration of bankruptcy, enforcement and preservation actions (*azioni esecutive e cautelari*) on a debtor's assets are stayed, with very few exceptions (such as: (i) enforcement actions on mortgaged assets according to mortgage credit rules (*credito fondiario*) as set out in Italian Banking Act; (ii) in very limited cases and under certain circumstances, creditors secured by a lien (*pegno*) or a privilege (*privilegio*); and (iii) enforcement of financial collateral arrangements pursuant to the Financial Collateral Decree.

8.2 Are there any preference periods, clawback rights or other preferential creditors' rights (e.g., tax debts, employees' claims) with respect to the security?

Some acts, transactions and security interests may be subject to bankruptcy claw-back actions if such acts have been perfected during the so-called suspect period (from six months to one year depending on the circumstances), with very few exceptions. In particular, payments of debts which are due and payable may be clawed back if made in the six-month period preceding the declaration of bankruptcy.

Acts through which the debtor disposes of its assets may, under some conditions, be declared ineffective as a result of an ordinary claw-back action.

Gratuitous acts (*atti a titolo gratuito*) and prepayments (*pagamenti anticipati*) are *ex lege* ineffective if such acts have been made during the two-year period preceding the declaration of bankruptcy. In particular, prepayments can be revoked during such two-year period irrespective of whether the recipient was aware of the state of insolvency of the debtor.

Certain claims – expressly identified by operation of law (such as Italian tax and national social security contributions, employee arrears of wages or salary, etc.) – are preferred in the distribution of proceeds arising from the liquidation of the bankrupt's estate.

8.3 Are there any entities that are excluded from bankruptcy proceedings and, if so, what is the applicable legislation?

Companies carrying out commercial activity can be subject to the bankruptcy proceedings. Moreover, a company may be declared bankrupt when its size exceeds certain thresholds related to annual balance sheet assets, annual gross proceeds or indebtedness.

Italian companies which do not meet the above-mentioned thresholds (and physical persons in a situation of over-indebtedness) are subject to smaller bankruptcy proceedings (so-called *procedura da sovraindebitamento*).

In addition, special insolvency proceedings are applicable to large corporations (*grandi imprese*), public entities (*enti pubblici*) and regulated entities such as banks and insurance companies.

8.4 Are there any processes other than court proceedings that are available to a creditor to seize the assets of a company in an enforcement?

Pursuant to the Financial Collateral Decree, the beneficiary of financial collateral may, under certain conditions, satisfy its claims by way of appropriation or private sale without the involvement of the court, even whilst a bankruptcy proceeding is pending.

For certain types of security, such as pledges over shares, the parties may also agree – in the original security agreement or at any time thereafter – that the enforcement can take place by means of a private sale.

9 Jurisdiction and Waiver of Immunity

9.1 Is a party's submission to a foreign jurisdiction legally binding and enforceable under the laws of your jurisdiction?

An Italian Court will generally decline jurisdiction if the parties have submitted a dispute (either present or future) to the jurisdiction of a foreign court, subject to compliance with certain mandatory principles of law.

9.2 Is a party's waiver of sovereign immunity legally binding and enforceable under the laws of your jurisdiction?

Italian companies are generally not subject to sovereign immunity. In principle, waiver of sovereign immunity is not prohibited under Italian law. However the possibility for governmental or other public agencies and relevant personnel to waive their sovereign immunity should be assessed on a case-by-case basis.

10 Licensing

10.1 What are the licensing and other eligibility requirements in your jurisdiction for lenders to a company in your jurisdiction, if any? Are these licensing and eligibility requirements different for a "foreign" lender (i.e. a lender that is not located in your jurisdiction)? In connection with any such requirements, is a distinction made under the laws of your jurisdiction between a lender that is a bank *versus* a lender that is a non-bank? If there are such requirements in your jurisdiction, what are the consequences for a lender that has not satisfied such requirements but has nonetheless made a loan to a company in your jurisdiction? What are the licensing and other eligibility requirements in your jurisdiction for an agent under a syndicated facility for lenders to a company in your jurisdiction?

Lending activity in Italy, to the extent it is conducted on a professional basis and is addressed to the general public, is regulated by the provisions set out under the Italian Banking Act and its implementing regulations. Pursuant to these, the only entities authorised to carry out lending activities in Italy are the following:

- licensed banks, which include:
  - Italian banks;
  - EU passported banks; and
  - non-EU banks licensed in Italy;
- financial institutions enrolled in a special register held by the Bank of Italy pursuant to Article 106 of the Italian Banking Act;
- EU-based financial companies that are controlled by a bank incorporated in the same EU country;
- securitisation special purpose vehicles incorporated pursuant to the Italian Securitisation Law;
- Italian insurance companies; and
- following certain relatively recent amendments introduced into the Italian legal system, Italian alternative close-ended investment funds and, subject to particular conditions and requirements, EU alternative close-ended investment funds.

Banks which are not established in an EU Member State may only engage in lending in Italy if they are explicitly authorised to do so (and granted a licence to this effect) by the Bank of Italy.

Lending activity (described in the relevant regulations as "the granting of finance in whatever form") includes the traditional direct granting of loans as well as other activities (including issues of guarantees, leasing, factoring and the purchase of receivables for consideration) which amount to lending.

The violation of the prohibition described above may lead to a variety of penalties and sanctions, depending on the actual circumstances of the relevant case and which, in addition to severe monetary penalties, may in certain cases also involve criminal charges.

A specific set of exemptions is provided for intragroup financings, where such financings are made in favour of parent companies, subsidiaries and affiliates and, more generally, to companies belonging to the same group, but with certain further restrictions if the lending is in the form of purchase of receivables.

11 Other Matters

11.1 Are there any other material considerations which should be taken into account by lenders when participating in financings in your jurisdiction?

Under Italian law, the granting of financings is subject to certain mandatory rules relating to:

- Usury: in Italian law financing transactions, the applicable rate of interest (plus applicable fees and expenses) cannot exceed a certain threshold (which varies depending on the type of financing transaction) determined by the Bank of Italy on a quarterly basis.
- Compounding of interest: this is generally prohibited in financing transactions, save for certain limited cases.
- Transparency: financing transactions entered into by banks and financial intermediaries where the terms and conditions are unilaterally imposed by such entities and are not subject to individual negotiation with the client are subject to certain mandatory rules enacted by the Bank of Italy which are aimed at simplifying the understanding of the legal and economic terms of the financing transaction by the client.

Acknowledgment

The authors would like to acknowledge the contribution of their colleague Pietro Scarfone for this chapter.

Pietro is a dual-qualified banking and finance partner (English and Italian law) with more than 15 years' experience of advising domestic and international clients (both lenders and borrowers) in the areas of leveraged finance, acquisition finance, general corporate lending, real estate finance, infrastructure and ECA-backed finance and debt restructuring.

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ALLEN & OVERY

Allen & Overy is a full-service global elite law firm headquartered in London. Our commitment to help our clients deliver their global strategies has seen us build a truly global network now spanning 44 offices in 31 countries. We have also developed strong ties with more than 450 relationship firms in 118 countries where we do not have a presence. In this way we are able to deliver high-quality advice in 99% of the world's economies.

For more than 20 years, Allen & Overy has been one of Italy's premier legal practices, offering domestic and cross-border legal services to the world's leading corporations and financial institutions. Based in Milan and Rome, our lawyers have an in-depth knowledge of the local market and its related dynamics and players, and are able to combine that with our international reach and sector expertise.

Ivory Coast

Annick Imboua-Niava

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1 Overview

1.1 What are the main trends/significant developments in the lending markets in your jurisdiction?

Lending market activity is showing strong growth in Côte d'Ivoire as local banks and international financial institutions, either separately or together, are becoming involved in many extension or development projects by private borrowers, mainly being mid-size or large companies.

With the increase of the public and private partnership sector, financial institutions are showing great interest in providing assistance to government entities as well.

The main challenge for borrowers within the lending sector is the negotiation of a low interest rate and an overall global interest rate for financings.

1.2 What are some significant lending transactions that have taken place in your jurisdiction in recent years?

Important secured financings have taken place over recent years within the construction sector, including the construction of hotels – notably the financing of construction and rehabilitation of industrial zones in Côte d'Ivoire for an amount of about €127,000,000 – or the facility granted by AFREXIMBANK for the construction of roads in one OHADA country for €100,000,000.

2 Guarantees

2.1 Can a company guarantee borrowings of one or more other members of its corporate group (see below for questions relating to fraudulent transfer/financial assistance)?

Subject to compliance with the OHADA rules on securities and commercial companies, a limited company may guarantee the obligations of one or more other members of its corporate group. Further details are provided in the answers below.

2.2 Are there enforceability or other concerns (such as director liability) if only a disproportionately small (or no) benefit to the guaranteeing/securing company can be shown?

The OHADA rules on securities allow a third party to grant a security for another party without being the beneficiary of the loan. However, regarding important financial transactions, some restrictions apply in order to avoid a financial strain on the guarantor, a hidden value transfer or even money laundering.

Indeed, a guarantee or security interest granted by a limited company should not exceed the financial capabilities of the guarantor. As such, it is the lender's duty to ensure the financial capabilities of the guarantor when requesting such guarantee and the obligation of the guarantor to provide Board and/or shareholder approval of the transaction and the security package to mitigate the directors' liability risk and protect the minority shareholders' interests.

When it comes to a group of companies, the benefit of the company granting the security within a financial transaction concluded by another entity of the group must also be looked at to avoid unlawful value transfer and too much of a burden on that company. However, when a parent company which fully owns a subsidiary grants a security, there is no risk of unlawful value transfer because it is considered a full beneficiary of the loan. The only restriction would be to look at the fiscal implications of the financing when the subsidiary is in a different jurisdiction.

2.3 Is lack of corporate power an issue?

Only the legal representative of the company or any other person expressly designated can execute a finance transaction and grant securities attached to it. This legal representative must obtain the approval of the Board and/or the shareholders.

This should be a condition precedent before the finance documents are signed.

2.4 Are any governmental or other consents or filings, or other formalities (such as shareholder approval), required?

No governmental approvals are required in order for a private entity to provide guarantees or grant security interests.

Shareholder approval is generally not required for public limited companies (unless requested in the articles of incorporation), but the Board of Directors must approve the granting of guarantees and security interests. Shareholder approval is required for private limited companies.

Any personal guarantee granted by an individual must comply with the OHADA rules on personal security, such as handwritten consent of the amount and duration of the loan.

2.5 Are net worth, solvency or similar limitations imposed on the amount of a guarantee?

For a local bank financing a company, the common banking rules of the WAEMU (West African Economic and Monetary Union) zone provide that the bank ensures that the borrower is able to repay the loan. As such, it is generally imposed by the lender as a CP – a non-bankruptcy certificate from the corporate registry where the borrower is incorporated.

In case a security has been granted despite the existence of an insolvency procedure of the guarantor, Côte d'Ivoire courts will declare the security void.

2.6 Are there any exchange control or similar obstacles to enforcement of a guarantee?

Exchange control provisions apply on top of the financing transaction, mainly regarding the disbursement of the loan. The enforcement of a guarantee must comply with local OHADA rules as long as the asset granted as a security is located in Côte d'Ivoire.

3 Collateral Security

3.1 What types of collateral are available to secure lending obligations?

There are a number of different types of collateral and security interests available under OHADA law. The most common are the pledge agreement for agricultural goods or the pledge of professional equipment, mortgages, and the assignment of receivables.

3.2 Is it possible to give asset security by means of a general security agreement or is an agreement required in relation to each type of asset? Briefly, what is the procedure?

A separate agreement is necessary for each security granted. It is explained by the fact that each type of security has its own legal regime and requirements. For instance, when the law requests a registration of the security at the corporate registry, it is necessary to have a separate agreement to comply with such requirement.

We commonly see a facility agreement providing for all the securities that must be granted, but there is no general security agreement signed for all the securities to be granted and covering different assets.

Notwithstanding the above, it is possible to designate a security agent that will manage all the securities and ensure that they all comply with the applicable law.

3.3 Can collateral security be taken over real property (land), plant, machinery and equipment? Briefly, what is the procedure?

A security over real property is granted by a mortgage. Such agreement must comply with the local rules and be drafted by a notary public. Evaluation of the property must be conducted and proof of ownership provided. The agreement must outline whether it is granting first, second or third rank because the guarantor may have already granted a mortgage over the same property.

However, for machinery and equipment, a pledge is granted. This pledge does not prevent the guarantor from using the equipment. The equipment must be clearly described and the agreement must be registered at the corporate registry in order to be opposable to third parties.

3.4 Can collateral security be taken over receivables? Briefly, what is the procedure? Are debtors required to be notified of the security?

In granting an assignment of receivables, the guarantor must send a notification to his debtor; otherwise the debtor will continue to pay directly to the guarantor. Specific indications must be provided to the debtor regarding the payment modalities; for instance, providing another bank account where the secured debtor shall make the payments or designating the secured party or his representative.

In addition to the assignment of receivables considered as a security under OHADA law, we also have the delegation of receivables which is also a security but only under the general civil rules. A delegation of insurance proceeds is the most common security used. It still requires a notification or an acceptance of the insurer to avoid later litigation on the beneficiary of the sums to be paid.

3.5 Can collateral security be taken over cash deposited in bank accounts? Briefly, what is the procedure?

Security can be granted over cash deposited in bank accounts and the bank account holder must be notified of the security granted.

Such security is granted by way of an account pledge for the benefit of the lender. In order for the pledge to be perfected and enforceable, the guarantor must waive all disposal rights to the bank account. Such bank account pledge should therefore not be secured for an account used in the day-to-day activities of the guarantor.

The bank account pledge is most effective on a deposit account, which is generally the account where the receivables pledged are paid.

3.6 Can collateral security be taken over shares in companies incorporated in your jurisdiction? Are the shares in certificated form? Can such security validly be granted under a New York or English law governed document? Briefly, what is the procedure?

Security over shares of a company incorporated in Côte d'Ivoire can only be granted under OHADA law.

The pledge agreement needs to be registered at the corporate registry and the share register of the company must mention the security granted. There is no direct transfer of the shares as long as the facility agreement is still pending and default of payment has not yet been demonstrated.

3.7 Can security be taken over inventory? Briefly, what is the procedure?

A pledge granted over agricultural goods is generally granted with the involvement of a collateral management agreement. The goods are kept in the warehouse of the collateral manager who has the obligation to control the reception and exportation of the goods.

3.8 Can a company grant a security interest in order to secure its obligations (i) as a borrower under a credit facility, and (ii) as a guarantor of the obligations of other borrowers and/or guarantors of obligations under a credit facility (see below for questions relating to the giving of guarantees and financial assistance)?

Yes, subject to compliance with the applicable laws as described in question 2.2.

3.9 What are the notarisation, registration, stamp duty and other fees (whether related to property value or otherwise) in relation to security over different types of assets?

Stamp duties are applied on the agreements before they are registered at the corporate registry of the commercial court. Registration fees are also applicable and paid based on a rate on the principal secured obligation.

Notarisation of the agreements is necessary when it comes to a mortgage. Fees are paid on the basis of the value of the secured obligation.

It is the borrower's duty to pay all the fees incurred by the facility.

3.10 Do the filing, notification or registration requirements in relation to security over different types of assets involve a significant amount of time or expense?

Most security interests are established more or less immediately. The applicable costs are those mentioned in question 3.9. Lawyers' fees for counselling the lending bank are the borrower's responsibility.

3.11 Are any regulatory or similar consents required with respect to the creation of security?

There are no such consents required.

3.12 If the borrowings to be secured are under a revolving credit facility, are there any special priority or other concerns?

No, there are not.

3.13 Are there particular documentary or execution requirements (notarisation, execution under power of attorney, counterparts, deeds)?

There are no such requirements. However, if the credit facility is under Côte d'Ivoire law, stamp duties will apply to confirm the date of signature.

4 Financial Assistance

4.1 Are there prohibitions or restrictions on the ability of a company to guarantee and/or give security to support borrowings incurred to finance or refinance the direct or indirect acquisition of: (a) shares of the company; (b) shares of any company which directly or indirectly owns shares in the company; or (c) shares in a sister subsidiary?

The restrictions are set out in the OHADA Uniform Act on Commercial Companies and the Uniform Act on Securities. Indeed, it is forbidden to provide financial assistance to a borrower with the purpose of acquiring shares in the company.

5 Syndicated Lending/Agency/Trustee/Transfers

5.1 Will your jurisdiction recognise the role of an agent or trustee and allow the agent or trustee (rather than each lender acting separately) to enforce the loan documentation and collateral security and to apply the proceeds from the collateral to the claims of all the lenders?

Lenders may appoint a facility and/or security agent to represent them in all matters relating to the finance documents as well as any security interests. Such agents are allowed to enforce any rights that the lenders might have under the finance documents. Furthermore, the agent may enforce any collateral security and apply the proceeds from such enforcement in order to satisfy the secured claims of the lenders.

5.2 If an agent or trustee is not recognised in your jurisdiction, is an alternative mechanism available to achieve the effect referred to above which would allow one party to enforce claims on behalf of all the lenders so that individual lenders do not need to enforce their security separately?

This does not apply; see question 5.1 above.

5.3 Assume a loan is made to a company organised under the laws of your jurisdiction and guaranteed by a guarantor organised under the laws of your jurisdiction. If such loan is transferred by Lender A to Lender B, are there any special requirements necessary to make the loan and guarantee enforceable by Lender B?

A transfer of a loan is perfected and made valid and enforceable against third parties by way of an assignment of receivables and due notification of the debtor under the loan that is being transferred.

6 Withholding, Stamp and Other Taxes; Notarial and Other Costs

6.1 Are there any requirements to deduct or withhold tax from (a) interest payable on loans made to domestic or foreign lenders, or (b) the proceeds of a claim under a guarantee or the proceeds of enforcing security?

When the lender is a foreign entity, the borrower is required to withhold taxes on the revenue of interests paid to the lender.

6.2 What tax incentives or other incentives are provided preferentially to foreign lenders? What taxes apply to foreign lenders with respect to their loans, mortgages or other security documents, either for the purposes of effectiveness or registration?

Unless there is a tax treaty between Côte d'Ivoire and the country of the foreign lender, there is no other tax incentive.

Taxes due by the lender are mainly those on the revenue of interests paid. The other taxes incurred by the loan are the obligation of the borrower.

6.3 Will any income of a foreign lender become taxable in your jurisdiction solely because of a loan to, or guarantee and/or grant of, security from a company in your jurisdiction?

The income from the interest paid by the borrower is taxable in Côte d'Ivoire.

6.4 Will there be any other significant costs which would be incurred by foreign lenders in the grant of such loan/guarantee/security, such as notarial fees, etc.?

Please see question 3.9 above.

6.5 Are there any adverse consequences for a company that is a borrower (such as under thin capitalisation principles) if some or all of the lenders are organised under the laws of a jurisdiction other than your own? Please disregard withholding tax concerns for purposes of this question.

There are no adverse consequences in such case. The lenders are only requested to comply with local mandatory rules are far as securities are concerned.

7 Judicial Enforcement

7.1 Will the courts in your jurisdiction recognise a governing law in a contract that is the law of another jurisdiction (a "foreign governing law")? Will courts in your jurisdiction enforce a contract that has a foreign governing law?

Yes, as long as the public order of Côte d'Ivoire is not threatened.

The courts of Côte d'Ivoire will not recognise the choice of a foreign law as the governing law of the facility agreement if such law was chosen as a method of avoiding rules or regulations of another jurisdiction which, as a matter of public policy, the courts of Côte d'Ivoire regard as being properly relevant to the facility agreement.

7.2 Will the courts in your jurisdiction recognise and enforce a judgment given against a company in New York courts or English courts (a "foreign judgment") without re-examination of the merits of the case?

No matter what foreign law governs the facility agreement, it is important to note that a foreign judgment is not directly enforceable in Côte d'Ivoire. It must go through the procedure of "Exequatur". This is not a re-litigation of the case, but a formal review of the case by a domestic competent court that would eventually render the judgment enforceable in Côte d'Ivoire.

The Exequatur is awarded when the following requirements are met:

- The decision must be provided from a competent jurisdiction according to the applicable laws of the country where it was made.
- The decision is not subject to appeal and is enforceable in that country.
- Due process has been observed: the condemned party must be called to the proceeding and must be given the opportunity to defend itself.
- There is no contradictory decision already in existence in Côte d'Ivoire before the foreign one has been rendered concerning the same case and the same parties.
- The decision is not contrary to public order.

7.3 Assuming a company is in payment default under a loan agreement or a guarantee agreement and has no legal defence to payment, approximately how long would it take for a foreign lender to (a) assuming the answer to question 7.1 is yes, file a suit against the company in a court in your jurisdiction, obtain a judgment, and enforce the judgment against the assets of the company, and (b) assuming the answer to question 7.2 is yes, enforce a foreign judgment in a court in your jurisdiction against the assets of the company?

The time a litigation procedure takes is highly dependent on the complexity of the case and the administrative organisation of the local courts.

Our experience leads us to advise that at least 12 months are necessary in order to obtain an enforceable decision (obtainment of an appeal decision included).

7.4 With respect to enforcing collateral security, are there any significant restrictions which may impact the timing and value of enforcement, such as (a) a requirement for a public auction, or (b) regulatory consents?

There are no significant restrictions in our jurisdiction.

7.5 Do restrictions apply to foreign lenders in the event of (a) filing suit against a company in your jurisdiction, or (b) foreclosure on collateral security?

There are no significant restrictions in our jurisdiction.

7.6 Do the bankruptcy, reorganisation or similar laws in your jurisdiction provide for any kind of moratorium on enforcement of lender claims? If so, does the moratorium apply to the enforcement of collateral security?

Yes. Please see question 8.1 below.

7.7 Will the courts in your jurisdiction recognise and enforce an arbitral award given against the company without re-examination of the merits?

Yes. The Exequatur rules apply here too.

8 Bankruptcy Proceedings

8.1 How does a bankruptcy proceeding in respect of a company affect the ability of a lender to enforce its rights as a secured party over the collateral security?

Following a bankruptcy order, no independent enforcement is, as a general rule, available for secured creditors. A creditor that has a valid and perfected pledge is paid by preference before other creditors who do not have a security.

8.2 Are there any preference periods, clawback rights or other preferential creditors' rights (e.g., tax debts, employees' claims) with respect to the security?

Preferential creditor rights are granted to: employees' claims; tax debts, legal expenses; security interests over real estate property; and security interests benefiting from a retention right (such as a share pledge, a securities account pledge or a bank account pledge).

8.3 Are there any entities that are excluded from bankruptcy proceedings and, if so, what is the applicable legislation?

Legal entities are mainly subject to bankruptcy proceedings.

8.4 Are there any processes other than court proceedings that are available to a creditor to seize the assets of a company in an enforcement?

There may be a direct transfer of the property when a mortgage is granted by a legal entity to another legal entity.

9 Jurisdiction and Waiver of Immunity

9.1 Is a party's submission to a foreign jurisdiction legally binding and enforceable under the laws of your jurisdiction?

Yes. The principles of freedom of choice of law and choice of forum apply when it concerns facility agreements, but not security agreements when the assets are located in Côte d'Ivoire.

9.2 Is a party's waiver of sovereign immunity legally binding and enforceable under the laws of your jurisdiction?

Waivers of sovereign immunity from jurisdiction are legally binding and enforceable under the laws of Côte d'Ivoire.

However, a waiver of sovereign immunity from jurisdiction does not entail a waiver of immunity from execution, which must be separately expressed in order for it to be equally binding and enforceable.

10 Licensing

10.1 What are the licensing and other eligibility requirements in your jurisdiction for lenders to a company in your jurisdiction, if any? Are these licensing and eligibility requirements different for a "foreign" lender (i.e. a lender that is not located in your jurisdiction)? In connection with any such requirements, is a distinction made under the laws of your jurisdiction between a lender that is a bank *versus* a lender that is a non-bank? If there are such requirements in your jurisdiction, what are the consequences for a lender that has not satisfied such requirements but has nonetheless made a loan to a company in your jurisdiction? What are the licensing and other eligibility requirements in your jurisdiction for an agent under a syndicated facility for lenders to a company in your jurisdiction?

A local entity granting credit must have a licence to do so in order to be called a bank or financial entity. The same requirement is not applicable when the borrower has obtained a loan from a foreign entity.

The security agent regime is governed by the OHADA Uniform Act on Securities.

11 Other Matters

11.1 Are there any other material considerations which should be taken into account by lenders when participating in financings in your jurisdiction?

The key legal issues to be considered when lending to Côte d'Ivoire entities, and taking security over Côte d'Ivoire assets, have been addressed above.

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A well-experienced corporate lawyer, Osther Tella advises important local companies as well as international financial institutions such as Afrexim Bank, AFRICINVEST FUND, FORTIS, etc. He is also mainly in charge of building and following up on structured financing projects for several international banks, including development and investment banks such as PROPARCO, DEG. He has been involved in public and private partnerships several times, for instance in an urban train project in Abidjan. He often executes various missions, especially due diligence on general legal issues and labour law issues for parent companies, subsidiaries and branches of large groups in West and Central Africa. In addition, Osther Tella is specialised in sports law, as the sector is in need of competent legal professionals in Africa.

Imboua - Kouao - Tella & Associes

The law firm SCPA IMBOUA – KOUAO – TELLA & ASSOCIES is a certified law firm registered at the Côte d'Ivoire Bar Association, which was effectively created in January 2009.

It is a business-oriented law firm, with an emphasis on structured financing and corporate law. The IKT law firm team is composed of lawyers and in-house counsel, all bilingual, with strong experience in local and international transactions.

Regarding its litigation practice, the firm represents clients before all types of tribunals, whether it is in the regulatory first instance or appellate courts, and also before alternative dispute resolution tribunals such as the Arbitration Court of Côte d'Ivoire (CACI) and the OHADA Justice Arbitration Court (CCJA).

As for counselling matters, the firm aims to serve the needs of companies and individuals looking for the best advice to help them in their day-to-day or complex business decisions. As such matters are diverse and require the most time, we strongly analyse the client's activity and the legal issues they raise in terms of compliance and mitigation of risks.

In addition, IKT law firm regularly organises seminars with local clients to update them on new trends of the law regarding their activities.

The lawyers of IKT regularly take part in UIA meetings and training activities to extend their potential and network. The firm is also referenced in global directories as a firm with a strong potential in international transactions.

Japan

Taro Awataguchi

Yuki Kohmaru

Anderson Mori & Tomotsune

1 Overview

1.1 What are the main trends/significant developments in the lending markets in your jurisdiction?

Japanese lending has traditionally relied upon mortgages over real estate to secure loans. In the case of small and medium-sized entities, personal guarantees by representative directors of the borrowers have also been common (a guideline called the "*keieisha-hosho* guideline" on this type of guarantee became effective on February 1, 2014). While new types of asset-backed or cash flow financing such as (i) acquisition financing (leveraged buyout (LBO) financing, etc.), (ii) asset-based lending (ABL), (iii) debtor-in-possession (DIP) financing, and (iv) project financing are developing in Japan, the traditional practice of lending against real estate collateral remains one of the preferred methods among Japanese banks.

1.2 What are some significant lending transactions that have taken place in your jurisdiction in recent years?

Since the great earthquake and tsunami of March 11, 2011, there has been growing anti-nuclear sentiment in Japan and intensified analysis by policymakers regarding Japan's energy demands. Financing the costs of alternative clean energy solutions (such as solar, wind, hydro-power and geothermal) through project financing structures is one of the key focuses in Japan now and for the next decade.

2 Guarantees

2.1 Can a company guarantee borrowings of one or more other members of its corporate group (see below for questions relating to fraudulent transfer/financial assistance)?

Yes, guarantees from related companies are permissible in Japan.

2.2 Are there enforceability or other concerns (such as director liability) if only a disproportionately small (or no) benefit to the guaranteeing/securing company can be shown?

In general, there are no enforceability concerns, although directors may be personally in breach of their duty of care under the Companies Act (Act No. 86 of July 26, 2005, as amended) in such situations. That said, if only a disproportionately small benefit or no benefit at all is received by the guarantor, in a bankruptcy proceeding of the guarantor, the guarantee may be subject to avoidance by the bankruptcy trustee.

2.3 Is lack of corporate power an issue?

Corporate power is necessary for a guarantor to grant guarantees.

2.4 Are any governmental or other consents or filings, or other formalities (such as shareholder approval), required?

The Civil Code (Act No. 89 of April 27, 1896, as amended) requires that any guarantee agreement must be in writing. Shareholder approval is not required. Depending upon the materiality of the amount guaranteed, the board of directors' approval may be required. In practice, the loan and/or guarantee agreement will contain a representation and warranty as to the board of directors' approval, and such approval will often be a condition precedent to funding a loan.

2.5 Are net worth, solvency or similar limitations imposed on the amount of a guarantee?

Japanese law does not provide net worth, solvency or similar limitations on the amount of a guarantee. (Please note that, where an obligor has the obligation to furnish a guarantor, such guarantor must be a person with capacity to act, and have sufficient financial resources to pay the obligation. This does not apply in cases where the creditor designated the guarantor.)

2.6 Are there any exchange control or similar obstacles to enforcement of a guarantee?

No. However, please note that a payment exceeding JPY 30,000,000 from a resident in Japan to overseas by way of bank remittance may be subject to reporting requirements.

3 Collateral Security

3.1 What types of collateral are available to secure lending obligations?

In Japan, many types of property may be pledged to secure debt obligations, including real property (buildings and land), plant, machinery, equipment, receivables, accounts, shares and inventory.

3.2 Is it possible to give asset security by means of a general security agreement or is an agreement required in relation to each type of asset? Briefly, what is the procedure?

Different types of security interests may be created by one security agreement; however, as discussed in questions 3.3 to 3.8 below, the security interest in each type of asset must be perfected separately.

3.3 Can collateral security be taken over real property (land), plant, machinery and equipment? Briefly, what is the procedure?

(1) Real property (land)

Under Japanese law, a typical security interest upon real property is a mortgage (*teito-ken*). For a revolving facility with a maximum claim amount (*kyokudo-gaku*), a revolving mortgage (*ne-teito-ken*) is applicable.

A mortgage on land or a building is created by an agreement between a mortgagor and a mortgagee. In order 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 such 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 (i) the name and address of the debtor and mortgagor, (ii) the origin and date of the mortgage, (iii) the priority, and (iv) the claim amount (in the case of a revolving mortgage, the maximum claim amount). Though various covenants and other provisions may be included in the mortgage agreement, the full mortgage agreement is not recorded in the registration. Only the registrable items including those enumerated above will appear in a registration.

(2) Plant

A typical "plant" consists of land, a building, machinery and equipment. As mentioned above, land and a building can be collateralised by a mortgage (*teito-ken* or *ne-teito-ken*). Machinery and equipment are classified as movables, and can be collateralised by a security interest (*joto-tanpo*) (discussed below).

In addition, Japanese law provides for two comprehensive security interests for property located in a factory. One is a factory mortgage (*kojo-teito-ken*), and the other is a factory estate mortgage (*kojo-zaidan-teito-ken*). A factory mortgage over the land covers all machinery and equipment located in the factory. A factory estate mortgage is a very strong security interest that can actually eliminate pre-existing security interests over movables in the factory estate. Notice regarding the factory estate is published in the Japanese official gazette and if an existing security interest holder fails to object within a certain period (specified from one to three months), the existing security interest is extinguished. Both a factory mortgage and a factory estate mortgage require identification of each piece of machinery and equipment, and therefore require more burdensome procedures and costs than normal types of mortgages. The factory mortgage and factory estate mortgage are not very common and are used mostly for large factories.

(3) Machinery and equipment

Machinery and equipment are movables. Movables can be collateralised by way of assignment as security (*joto-tanpo*). This security interest can be created by a security agreement between an assignor and an assignee. In order to perfect this security interest, the target movable must be "delivered" from the assignor to the assignee. Delivery can be made by (i) physical delivery, (ii) constructive delivery, or (iii) (where the assignor is a legal entity (including a company)) if a movable assignment registration (*dosan-joto-toki*) is filed with the LAB, the registration itself is deemed delivery from the assignor to the assignee. The LAB located in the Nakano Ward of Tokyo is the exclusive designated LAB for any movable assignment registration.

In creation of *joto-tanpo*, it is necessary to identify the target movable by whatever means is enough to specify it, such as kind, location, number and so forth. This identification rule is also applicable in perfection of *joto-tanpo* by way of physical or constructive delivery. In perfection by movable assignment registration, there are two statutory ways to identify the target movable: (i) specification by kind and a definitive way to specify the target (such as a serial number); and (ii) specification by kind and location. The former is usually used for a fixed asset, and the latter is usually used for inventory (aggregate movables).

Note that the movable assignment registration is compiled by the assignor (not by the target movable). Therefore, unlike a real estate registration which can be searched by the property, a movable assignment registration cannot be searched by the target movable, and priority cannot be registered because there is no statutory registration system to reflect the priority in the movable assignment registration. There is continued debate as to whether a second lien (*joto-tanpo*) is valid. Anyone can search whether an assignor has already filed a movable assignment registration and obtain an outline certificate of the registration for a fee of JPY 500. If there is no existing movable assignment registration filed with the LAB, a certificate of non-existence of movable assignment registration will be issued. However, this does not mean there is no physical or constructive delivery. Therefore, it is necessary to perform due diligence with respect to possible physical or constructive delivery by an assignor. If a movable assignment registration has been filed with the LAB, the outline certificate describes (i) the existence of such registration, (ii) the timing of the assignment, and (iii) the name and address of the assignee, but it does not provide detailed information regarding the target movable. A comprehensive registration certificate is only accessible to limited persons, and in practice, a lender will ask the debtor to obtain the latest comprehensive certificate.

3.4 Can collateral security be taken over receivables? Briefly, what is the procedure? Are debtors required to be notified of the security?

A security interest in receivables (claim) may be taken by a pledge (*shichi-ken*) or assignment as security (*joto-tanpo*). These security interests can be created by a security agreement between the pledgor/assignor and pledgee/assignee.

In creation of 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 (*shorai-saiken*, "future claim"), the period (beginning and end dates of the period during which the claim will be generated) 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 which prohibits pledge/assignment of the target receivable, the pledge/assignment is basically invalid, with two exceptions: (i) if the pledgee/assignee is unaware of the prohibition agreement without gross negligence, the pledge/assignment shall be valid; and (ii) the pledge/assignment will become valid retroactively from the time of the pledge/assignment (to the extent not harmful to a third party) if the obligor of the target receivable consents to the pledge/assignment, even if there has been a prohibition agreement.

The pledgee/assignee can assert the security interest ***against the obligor of the target receivable*** upon (i) notice to the obligor from the pledgor/assignor, or (ii) acknowledgment of the obligor. The pledgee/assignee can assert the security interest ***against a third party*** (such as a double pledgee/assignee or bankruptcy trustee of the pledgor/assignor) upon (i) notice to the obligor of the target receivable from the pledgor/assignor by a certificate with (a stamp of) a fixed date, (ii) an acknowledgment of the obligor of the target receivable by a certificate with (a stamp of) a fixed date, or (iii) (only where the pledger/assignor is a legal entity (including a company)) a claim pledge/assignment registration with the special LAB located in Nakano Ward of Tokyo. 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 pledgor/assignor, and the notice must be accompanied by a registration certificate (this notice can be sent by the pledgee/assignee).

The claim assignment registration is not compiled based upon the target receivable, but by the assignor. Therefore, unlike the real estate registration, the claim assignment registration cannot be searched by the target receivables, and, as with movables, priority cannot be registered.

3.5 Can collateral security be taken over cash deposited in bank accounts? Briefly, what is the procedure?

There are various types of bank deposits in Japan. We will discuss two typical deposit claims used for a pledge: (i) a term deposit (*teiki-yokin*); and (ii) an ordinary deposit (*futsu-yokin*). Validity of a pledge over a term deposit is well established; however, there has been debate as to the validity of a pledge over an ordinary deposit because there is no Supreme Court decision addressing this issue. Nevertheless, a pledge over an ordinary deposit is often used for structured financing. As a pledge or assignment of a deposit is usually prohibited by the deposit agreement, a pledge without the bank's consent is invalid. A pledge over deposits is usually created by a standard form of pledge agreement created by the depository bank, including consent by such bank. If the bank's consent is made with a fixed date stamp, that consent constitutes perfection against a third party. If the lender is itself the depository bank, the bank can either set off or exercise the pledge over the deposit claim.

3.6 Can collateral security be taken over shares in companies incorporated in your jurisdiction? Are the shares in certificated form? Can such security validly be granted under a New York or English law governed document? Briefly, what is the procedure?

Under Japanese law, shares of stock companies (*kabushiki-kaisha*) incorporated in Japan can be pledged or assigned as security (*joto-tanpo*). The articles of incorporation of a Japanese stock company will specify whether the shares are represented by physical certificates. If the shares are "certificated" (i.e., if physical certificates representing the shares are issued or will be issued), a pledge can be created 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 usually unregistered and thus unknown to the issuer (*ryaku-shiki-shichi*), 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 (*toroku-shichi*), the dividend can be paid directly to the registered pledgee.

If the shares are not and will not be certificated, a pledge may be created by a security agreement between the pledgor and pledgee, and perfected against the issuer and any third party by registration of the pledge on the issuer's shareholders' list.

After January 5, 2009, all share certificates of all listed stock companies incorporated in Japan became null and void. The shares and shareholders of all listed companies are now subject to the book-entry system controlled by the Japan Securities Depositary Center, Inc. (JASDEC). 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.

Please note that a company which is not listed may, in its articles of incorporation, restrict the transfer of shares and make any transfer subject to the approval of the issuer (such as consent by the board of directors).

Since the valid creation and perfection of a pledge over shares of stock companies (*kabushiki-kaisha*) incorporated in Japan should be governed by Japanese law, it is not practically recommended to elect New York law or English law as the governing law of the security agreement.

3.7 Can security be taken over inventory? Briefly, what is the procedure?

Yes, inventory is usually treated as an aggregate movable. Creation and perfection are as discussed in question 3.3 above.

3.8 Can a company grant a security interest in order to secure its obligations (i) as a borrower under a credit facility, and (ii) as a guarantor of the obligations of other borrowers and/or guarantors of obligations under a credit facility (see below for questions relating to the giving of guarantees and financial assistance)?

Yes, subject to the other items discussed within this chapter regarding guarantees and security interests.

3.9 What are the notarisation, registration, stamp duty and other fees (whether related to property value or otherwise) in relation to security over different types of assets?

Registration taxes are imposed on (i) mortgage registration (0.4% of the claim amount (as for revolving mortgage, 0.4% of the maximum claim amount)), (ii) movable assignment registration (JPY 7,500 per a filing (up to 1,000 movables)), and (iii) claim assignment registration (JPY 7,500 per a filing (up to 5,000 claims) and JPY 15,000 per a filing (exceeding 5,000 claims)). Creation of assignment as security (*joto-tanpo*) over claims may be subject to a fixed stamp duty of JPY 200 as discussed in question 6.2.

3.10 Do the filing, notification or registration requirements in relation to security over different types of assets involve a significant amount of time or expense?

No, except for the factory estate mortgage which requires the procedures discussed in question 3.3 above.

3.11 Are any regulatory or similar consents required with respect to the creation of security?

No regulatory consents are required to grant security, except for general consents for transfers required by the terms of the asset itself (such as licences).

3.12 If the borrowings to be secured are under a revolving credit facility, are there any special priority or other concerns?

Taking an example of a revolving mortgage over real property, loans up to the registered maximum amount will be secured by the mortgage in accordance with the priority of the original registration filing.

3.13 Are there particular documentary or execution requirements (notarisation, execution under power of attorney, counterparts, deeds)?

In general, most of the official documents are executed with a registered seal. The seal registration certificate is also necessary (for example, for filing an official registration). In many cases, there are alternative ways available to foreign lenders.

4 Financial Assistance

4.1 Are there prohibitions or restrictions on the ability of a company to guarantee and/or give security to support borrowings incurred to finance or refinance the direct or indirect acquisition of: (a) shares of the company; (b) shares of any company which directly or indirectly owns shares in the company; or (c) shares in a sister subsidiary?

(a) Shares of the company: no.

(b) Shares of any company which directly or indirectly owns shares in the company: no.

(c) Shares in a sister subsidiary: no.

Apart from financial assistance restrictions, the directors of a company may be deemed in breach of their fiduciary duty of care if the company provides a guarantee or security to secure the borrowings of its shareholder without gaining any benefit in return (as discussed in question 2.2 above).

5 Syndicated Lending/Agency/Trustee/Transfers

5.1 Will your jurisdiction recognise the role of an agent or trustee and allow the agent or trustee (rather than each lender acting separately) to enforce the loan documentation and collateral security and to apply the proceeds from the collateral to the claims of all the lenders?

In the practice of Japanese syndicated loans, an agent usually exists for the syndicated group. However, even if one of the syndicated secured lenders serves as such an agent, it cannot enforce the security interest held by other creditors. In addition, enforcement on behalf of other creditors may be prohibited by the Attorney Act (Act No. 205 of June 10, 1949).

Under the general rule of the Civil Code and other related laws, it is generally understood that the “secured creditor” and the “security holder” must be the same person/entity (“Same Person/Entity Principle”). However, under a security trust system, separation between the “secured creditor” and the “security holder” can be achieved. Until 2007, based on the Secured Bonds Trust Act (Act No. 52 of March 13, 1905), such security trust system only applied to bonds. In 2007, a new Trust Act (Act No. 108 of December 15, 2006) provided for a more general security trust system. Under the new system, if a trust is created with a security interest as the trust property and the terms of the trust provide that the beneficiary is the creditor whose claim is secured, the trustee can be a security trustee (“Security Trust”). As the holder of the security interest, the security trustee may, within the scope of affairs of the Security Trust (subject to instruction by trust beneficiaries in many cases), file petitions for enforcement and take other actions necessary, including distribution of proceeds.

One of the benefits of using a Security Trust is that no individual transfer and perfection procedures are necessary when a secured creditor assigns its secured claims because the security holder does not change under the Security Trust.

However, this new Security Trust system is not used often. While the Trust Act was amended to provide for the Security Trust system, other Japanese laws have not been amended to conform and retain features of the Same Person/Entity Principle. This lack of harmonisation creates practical enforcement risks that have yet to be tested in Japanese courts.

5.2 If an agent or trustee is not recognised in your jurisdiction, is an alternative mechanism available to achieve the effect referred to above which would allow one party to enforce claims on behalf of all the lenders so that individual lenders do not need to enforce their security separately?

Under Japanese practice, when a Security Trust is not used, secured creditors (such as syndicated loan lenders) elect a “security agent” for administrative purposes only (“Security Administrative Agent”).

The basic difference between the security trustee and the Security Administrative Agent is that the Security Administrative Agent is not a holder of all collateral security for all secured creditors. As a result, with respect to the Security Administrative Agent, (i) perfection must be obtained individually for each secured creditor, (ii) when a secured creditor assigns its secured claim and its collateral security, individual perfection procedures to transfer the collateral security are required, and (iii) each secured creditor has to take enforcement actions under its own name notwithstanding that syndicated secured creditors typically act in concert (subject to the majority approval of the syndication group).

Under Japanese law, when several secured creditors share the single/same collateral in the same ranking, there are two possible legal structures (where applicable): (i) “independent and in the same ranking security” (“Same Rank Security”) where each secured creditor owns independent security of the same ranking; and (ii) “joint share security” where all secured creditors share one security (“Joint Security”). The basic difference is that each secured creditor may enforce its security in the Same Rank Security, while unanimous consent of all secured creditors is required to enforce security in the Joint Security. However, secured creditors in a Same Rank Security often enter into an inter-creditor agreement prohibiting individual secured creditors from enforcing the collateral security without majority consent; and, in the case of a syndicated loan, such inter-creditor arrangement is usually provided for in the collateral agreements to which all secured creditors each having a Same Rank Security are parties. Violation of the inter-creditor agreement does not invalidate the enforcement, but only constitutes a damage claim of the other secured creditors.

5.3 Assume a loan is made to a company organised under the laws of your jurisdiction and guaranteed by a guarantor organised under the laws of your jurisdiction. If such loan is transferred by Lender A to Lender B, are there any special requirements necessary to make the loan and guarantee enforceable by Lender B?

If the loan transfer is not prohibited by the terms of the loan documents, the loan can be transferred by agreement between Lenders A and B, and the guarantee is automatically transferred to the same assignee (Lender B). In order to perfect the loan transfer against the guarantor, according to a prevalent theory, either (i) a notice to the borrower, or (ii) consent by the borrower is sufficient. However, practically, it is sometimes prudent to send a certified notice to both the borrower and guarantor. In practice, however, instead of providing notice to both the borrower and guarantor, Japanese lenders often require certified written consents from both of them to be obtained in order to avoid any dispute regarding the transfer.

6 Withholding, Stamp and Other Taxes; Notarial and Other Costs

6.1 Are there any requirements to deduct or withhold tax from (a) interest payable on loans made to domestic or foreign lenders, or (b) the proceeds of a claim under a guarantee or the proceeds of enforcing security?

Yes. Under the Income Tax Act of Japan (Act No. 33 of March 31, 1965) ("Income Tax Act") and other relevant statutes, a 20.42% withholding tax (including Special Reconstruction Income Tax, which is imposed until December 2037) is levied on the interest paid to foreign lenders where such foreign lender is a corporation having neither a head nor main office in Japan under a loan.

However, if Japan and the country where the foreign lender resides are parties to a tax treaty (such as the United States or the United Kingdom), the withholding tax rate may be lowered or the obligation to withhold tax may be relieved entirely. For example, (i) no withholding tax is levied on interest paid to all UK lenders, and (ii) no more than 10% withholding tax is levied on interest paid to US lenders under the general rules provided by the tax treaties effective as of March 13, 2019. Under the tax treaty between the US and Japan, if a lender is a bank, insurance company or registered securities dealer, the obligation to withhold tax in Japan is relieved entirely. As of March 13, 2018, the tax treaty between the US and Japan is scheduled to be amended, subject to the US ratifying the amendment. After the amendment, all US lenders (including other lenders which are not listed above) are to be generally exempted from the withholding tax in Japan.

Withholding tax is not levied on interest paid to domestic lenders because that interest is taxed under the Corporation Tax Act of Japan (Act No. 34 of March 31, 1965) ("Corporation Tax Act").

6.2 What tax incentives or other incentives are provided preferentially to foreign lenders? What taxes apply to foreign lenders with respect to their loans, mortgages or other security documents, either for the purposes of effectiveness or registration?

Under the Corporation Tax Act and other local government tax laws, foreign creditors making loans to Japanese domestic borrowers, but not otherwise having a "permanent establishment" in Japan, are not required to pay (i) the national corporation income tax, (ii) the prefectural and municipal inhabitants' tax, or (iii) the prefectural enterprise tax. The effective corporate tax rate for the fiscal years commencing until March 31, 2018 is 29.97% (based on the standard tax rate, including local tax) and the effective corporate tax rate for the fiscal year commencing on or after April 1, 2018 is scheduled to be 29.74%. Activities in Japan such as (i) having a branch office, (ii) performing operating construction work for more than one year, or (iii) having independent agent(s), may constitute having a "permanent establishment" in Japan. If a tax treaty exists between Japan and the country where the foreign lender resides (such as the United States and the United Kingdom), special preferential tax treatment may be applicable to interest income.

A stamp tax is imposed based on the amount of indebtedness evidenced by a loan agreement and can range from JPY 200 to JPY 600,000. A flat fee stamp tax of JPY 200 is required for a guarantee. Collateral agreements such as mortgages and pledge agreements are in general not subject to additional stamp tax. However, certain types of collateral agreements collateralising claims (such as trade receivables) by way of assignment as security (*joto-tanpo*), as opposed to a pledge (*shichi-ken*) may be subject to a fixed stamp duty of JPY 200 applicable to claim assignment agreements.

Registration tax is discussed in question 3.9.

Stamp tax and registration tax apply without regard to the foreign or domestic status of a lender.

6.3 Will any income of a foreign lender become taxable in your jurisdiction solely because of a loan to, or guarantee and/or grant of, security from a company in your jurisdiction?

No. There is no corporation income tax or individual income tax under the Corporation Tax Act or the Income Tax Act specifically applicable to foreign lenders solely due to the fact they are lending to Japanese borrowers (or accepting a guarantee or security in connection with a loan to a Japanese borrower).

6.4 Will there be any other significant costs which would be incurred by foreign lenders in the grant of such loan/guarantee/security, such as notarial fees, etc.?

No. Documents can be notarised to facilitate compulsory execution in the future. If documents are notarised, a creditor does not need to obtain a court judgment when filing an attachment.

Possible additional fees include (i) process fees based on the Foreign Exchange and Foreign Trade Control Act (Act No. 228 of December 1, 1949) ("Foreign Exchange Act") (mainly attorneys' fees), (ii) attorneys' fees and other fees required to draft contracts and process various registrations, and (iii) tax accountant fees.

6.5 Are there any adverse consequences for a company that is a borrower (such as under thin capitalisation principles) if some or all of the lenders are organised under the laws of a jurisdiction other than your own? Please disregard withholding tax concerns for purposes of this question.

As a basic rule, before starting to lend in Japan, foreign lenders must acquire a licence as a "branch office of a foreign bank" residing in Japan under the Banking Act (Act No. 59 of 1981) or register as a "money lender" under the Money Lending Business Act (Act No. 32 of May 13, 1983).

Based on the Foreign Exchange Act, a foreign lender (including both individuals and corporations) which lends money to a Japanese corporation is required to report to a government authority (such as the Ministry of Finance) if certain conditions are met. In most cases, only *post facto* reporting is applicable, and it is usually not burdensome. Also, there are wide exemptions from the reporting requirement (including, but not limited to, such cases: (i) if the lender of loans is a bank or other financial institutions specified in a Cabinet Order; (ii) if the term of loans does not exceed one year; or (iii) if the amount of loans does not exceed JPY 100 million).

7 Judicial Enforcement

7.1 Will the courts in your jurisdiction recognise a governing law in a contract that is the law of another jurisdiction (a "foreign governing law")? Will courts in your jurisdiction enforce a contract that has a foreign governing law?

Yes; in principle, they will.

Article 7 of the Act on General Rules for Application of Laws (Act No. 78 of June 21, 2006) adopts a "party autonomy rule" whereby the formation and effect of a juridical act shall be governed by the law of the place chosen by the parties at the time of the act.

7.2 Will the courts in your jurisdiction recognise and enforce a judgment given against a company in New York courts or English courts (a "foreign judgment") without re-examination of the merits of the case?

Generally, courts in Japan will enforce a New York or English court judgment without re-examination of the merits; however, courts in Japan may evaluate the merits to the extent necessary to determine that the judgment satisfies the criteria for recognition.

Article 118 of the Code of Civil Procedure (Act No. 109 of June 26, 1996, as amended) ("Code of Civil Procedure") and Article 24 of the Civil Execution Act (Act No. 4 of March 30, 1979, as amended) ("Civil Execution Act") establish the mechanism for recognition and enforcement of foreign judgments.

The Civil Execution Act specifically provides that "the judgment granting execution shall be rendered without reviewing the substance of the judgment of a foreign court"; however, it also provides that (i) the foreign judgment must be final and non-appealable, and (ii) the judgment must fulfil the four conditions set out in Article 118 of the Code of Civil Procedure, as follows:

(i) The foreign court must have had jurisdiction over the defendant.

(ii) The defendant must have received adequate service of process.

(iii) The foreign judgment must not violate the public policy of Japan. Particular types of awards, such as punitive damages, may violate this requirement. When a public policy defence is raised, a Japanese court will look beyond the judgment to the underlying transaction. A defendant can also raise a public policy defence if the procedures through which the judgment was rendered were not consistent with Japanese public policy.

(iv) Reciprocity is assured. Japan has reciprocity with both the United States and England.

7.3 Assuming a company is in payment default under a loan agreement or a guarantee agreement and has no legal defence to payment, approximately how long would it take for a foreign lender to (a) assuming the answer to question 7.1 is yes, file a suit against the company in a court in your jurisdiction, obtain a judgment, and enforce the judgment against the assets of the company, and (b) assuming the answer to question 7.2 is yes, enforce a foreign judgment in a court in your jurisdiction against the assets of the company?

It differs depending upon the circumstances, but generally it would take approximately six months to one year to complete such proceedings.

7.4 With respect to enforcing collateral security, are there any significant restrictions which may impact the timing and value of enforcement, such as (a) a requirement for a public auction, or (b) regulatory consents?

If a secured lender intends to foreclose the secured assets non-consensually, it may file a petition for a public auction of the collateral with the court, if applicable (typically, real estate). Before payment is made by the winning bidder at the real estate auction, a private sale would take place if there is a consensual arrangement with the debtor.

Other than regulatory consents that may be specific to the nature of the collateral as a regulated asset, no general regulatory consents are required to enforce collateral.

7.5 Do restrictions apply to foreign lenders in the event of (a) filing suit against a company in your jurisdiction, or (b) foreclosure on collateral security?

In general, there are no restrictions on foreign lenders seeking to file suits against a company in Japan or to foreclosure on collateral.

7.6 Do the bankruptcy, reorganisation or similar laws in your jurisdiction provide for any kind of moratorium on enforcement of lender claims? If so, does the moratorium apply to the enforcement of collateral security?

Yes, the in-court insolvency proceedings described below provide a stay against the enforcement of certain claims.

Japanese law provides for two types of restructuring proceedings (Corporate Reorganisation and Civil Rehabilitation) and two types of liquidation proceedings (Bankruptcy and Special Liquidation).

In Corporate Reorganisation proceedings, unsecured and secured creditors are stayed from exercising their rights (security interests) outside of the proceedings.

In Civil Rehabilitation proceedings, unsecured creditors are stayed from exercising their rights outside of the proceedings, but secured creditors are not stayed from exercising their security interests (although secured creditors may become subject to a suspension order by the court having the effect of a temporary stay).

In Bankruptcy and Special Liquidation proceedings, unsecured creditors are stayed from exercising their rights outside of the proceedings, but secured creditors are not stayed from exercising their security interests (although secured creditors may become subject to a suspension order by the court in Special Liquidation proceedings).

7.7 Will the courts in your jurisdiction recognise and enforce an arbitral award given against the company without re-examination of the merits?

Yes. The Code of Civil Procedure does not specifically discuss the enforcement of a foreign arbitral award. However, Article 45 of the Arbitration Law (Act No. 138 of August 1, 2003) discusses recognition of arbitral awards generally, providing that "an arbitral award (irrespective of whether or not the place of arbitration is in the territory of Japan; this shall apply throughout this chapter) shall have the same effect as a final and conclusive judgment". The Arbitration Law is based upon the UNCITRAL Model Law on International Commercial Arbitration. Japan is also party to various international protocols and bilateral treaties, such as the New York Convention that addresses recognition and enforcement of foreign arbitral awards. Japan acceded to the New York Convention on June 20, 1961 and the Convention entered into force on September 18, 1961.

8 Bankruptcy Proceedings

8.1 How does a bankruptcy proceeding in respect of a company affect the ability of a lender to enforce its rights as a secured party over the collateral security?

As stated in question 7.6 above, in Corporate Reorganisation proceedings, secured creditors are stayed from enforcing their security interests. The claims of secured creditors will be treated as secured claims up to the value of the collateral as of the date of the commencement of the Corporate Reorganisation proceedings. Such value will be determined by way of an amicable settlement between the parties, a valuation order or a judgment by the court. Secured creditors will receive repayment in accordance with the reorganisation plan as approved by the borrower's creditors and confirmed by the court. In proceedings other than Corporate Reorganisation, secured creditors may enforce their security interests outside of the relevant proceedings. In practice, however, secured creditors sometimes refrain from exercising their security interests in exchange for settlements where the value of the relevant collaterals are agreed upon and repaid.

8.2 Are there any preference periods, clawback rights or other preferential creditors' rights (e.g., tax debts, employees' claims) with respect to the security?

In a Corporate Reorganisation proceeding, the Trustee exercises the right of avoidance. In the case of a Civil Rehabilitation proceeding, the Supervisor exercises the right of avoidance.

If a loan is "new money" and the collateral is fair equivalent value, the secured transaction (collateralisation) is, as a basic rule, not subject to avoidance. However, if the change of the type of the property (e.g. from real property to cash) gives rise to an actual risk of the debtor's disposition prejudicial to the unsecured ordinary creditors (in a Corporate Reorganisation, secured and unsecured creditors), and the debtor had such intention and the lender was aware of the debtor's intention as of the time of the transaction, such transaction may be subject to avoidance.

If a secured creditor obtained security for an existing debt knowing that the debtor became "unable to pay debts", the lien could be avoided. If collateralisation for an existing debt was carried out within 30 days prior to the debtor becoming "unable to pay debts" in the event where the debtor did not owe any duty to provide such security, it could also be avoided.

8.3 Are there any entities that are excluded from bankruptcy proceedings and, if so, what is the applicable legislation?

Among the four insolvency proceedings stated in question 7.6 above, Civil Rehabilitation and Bankruptcy are available for both legal entities (including companies) and individuals, while Corporate Reorganisation and Special Liquidation are limited to stock companies (*kabushiki-kaisha*). Note that there is a special legislation that applies to Corporate Reorganisation, Civil Rehabilitation and Bankruptcy proceedings of financial institutions (including banks).

8.4 Are there any processes other than court proceedings that are available to a creditor to seize the assets of a company in an enforcement?

A secured creditor may exercise its rights independently from the Civil Rehabilitation, Special Liquidation or Bankruptcy (however, in the Civil Rehabilitation and Special Liquidation, such exercise may be subject to a suspension order by the court).

9 Jurisdiction and Waiver of Immunity

9.1 Is a party's submission to a foreign jurisdiction legally binding and enforceable under the laws of your jurisdiction?

Under the Code of Civil Procedure, the amendment of which has been effective since April 1, 2012, the parties' agreement on the foreign (non-Japanese) jurisdiction is, as a basic rule, legally valid and enforceable if:

(i) it is made with respect to an action based on certain legal relationships and made in writing;
(ii) the designated foreign court is able to exercise its jurisdiction over the case by the foreign law and in fact; and
(iii) the exclusive jurisdiction of a court of Japan over an action in question is not provided for in laws or regulations.

Please note that jurisdiction over actions relating to (i) consumer contracts, or (ii) labour relationships are subject to the independent rule specified under the amended Code of Civil Procedure.

See question 7.2 regarding recognition of foreign judgments.

9.2 Is a party's waiver of sovereign immunity legally binding and enforceable under the laws of your jurisdiction?

A waiver of sovereign immunity is legally valid and enforceable subject to the conditions in the Act on the Civil Jurisdiction of Japan with respect to a Foreign State, etc. (Act No. 24 of April 24, 2009) (the "Immunity Act").

The Immunity Act is based on the United Nations Convention on Jurisdictional Immunities of States and Their Property (2004) and is effective from April 1, 2010.

10 Licensing

10.1 What are the licensing and other eligibility requirements in your jurisdiction for lenders to a company in your jurisdiction, if any? Are these licensing and eligibility requirements different for a "foreign" lender (i.e. a lender that is not located in your jurisdiction)? In connection with any such requirements, is a distinction made under the laws of your jurisdiction between a lender that is a bank *versus* a lender that is a non-bank? If there are such requirements in your jurisdiction, what are the consequences for a lender that has not satisfied such requirements but has nonetheless made a loan to a company in your jurisdiction? What are the licensing and other eligibility requirements in your jurisdiction for an agent under a syndicated facility for lenders to a company in your jurisdiction?

See questions 5.1, 5.2 and 6.5.

11 Other Matters

11.1 Are there any other material considerations which should be taken into account by lenders when participating in financings in your jurisdiction?

No; however, foreign lenders should note that court dockets in Japan are not available online and are not accessible to the general public. In general, there is also less transparency in court proceedings in Japan than in some jurisdictions, fewer hearings and *ex parte* communications are permitted. In particular, this lack of publicly available information can pose concerns for distressed debt investors regarding trading restrictions and non-public information.

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Jersey

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1 Overview

1.1 What are the main trends/significant developments in the lending markets in your jurisdiction?

We have seen further development in relation to Jersey headquartered financial services businesses with the Jersey Trust Company IPO being a significant transaction in the market. In the banking sector, the main theme has been the continuation and completion of a number of bank ring fencing schemes involving Jersey branches and subsidiaries. In many cases this has involved the transfer of loan books and security documentation.

As in respect of real estate finance, lending to Jersey corporate structures holding foreign real estate assets, including limited partnerships and unit trusts, dropped off slightly, mainly due to the decrease in activity in respect of prime London property.

The fund finance sector has remained strong, with high volumes of both new loans as well as re-financings of existing facilities. Facility sizes range from €50 million to over €1 billion, including capital call and subscription facilities as well as NAV, hybrid, co-investment and GP leverage.

Non-bank lenders have continued to provide financing which is not always available from larger financial institutions both to private individuals and businesses. The market still demands senior stretch and bridge loans for developers and we expect this to continue to require finance for the foreseeable future in respect of UK residential developments.

Listings on The International Stock Exchange of public and more specialist debt securities remain popular, as do the use of Jersey corporates as issuers for high-yield and corporate bonds.

1.2 What are some significant lending transactions that have taken place in your jurisdiction in recent years?

The majority of the lending transactions are confidential but loan amounts range from tens of millions to multi-billion EUR, USD or GBP loans. In the real estate sector recently, we have seen a number of transactions relating to REITs, for example in relation to the Blue Fin building in London.

We have advised on a number of fund finance transactions over €1 billion during the past year. Note issuance by Jersey-issuing entities has ranged from $100 million to over $1 billion.

During the past 12 months, we have advised on several significant acquisition finance transactions, including in relation to the acquisition of Jersey Financial Services businesses.

2 Guarantees

2.1 Can a company guarantee borrowings of one or more other members of its corporate group (see below for questions relating to fraudulent transfer/financial assistance)?

Yes, guarantees are commonly used by group companies. They are usually created by written agreement. Corporate benefit should be considered and this is covered in greater details at question 2.2 below.

The Security Interests (Jersey) Law 2012 (the "**Security Interests Law**") expressly provides that a security interest can be created to secure the obligation of a third party, which simplifies documentation and removes the need to include a limited recourse guarantee in Jersey security agreements.

2.2 Are there enforceability or other concerns (such as director liability) if only a disproportionately small (or no) benefit to the guaranteeing/securing company can be shown?

A Jersey company has unlimited corporate capacity under the Companies (Jersey) Law 1991 (the "**Companies Law**").

When a company enters into a finance transaction, a transacting party should consider whether there is corporate benefit for the company. There is a risk that a company could seek to have the transaction set aside on the basis that the directors approving the transaction were acting outside their statutory duty to act in the best interests of the company. This can happen where:

- there is little or no corporate benefit to the company; or
- the transacting party knows or ought to know that there is little or no corporate benefit.

This risk to directors can be avoided if both:

- all the shareholders of the Jersey company authorise or ratify the particular transaction; and
- the Jersey company can pay its debts as they fall due at the time of, and immediately following the entry into the transaction.

If there is no discernible corporate benefit to entry into a finance transaction, there is also a risk that a transaction could be set aside on the company's bankruptcy.

2.3 Is lack of corporate power an issue?

Article 18 of the Companies Law removed the concept of external *ultra vires*, meaning that nothing in a company's Memorandum or

Articles of Association can limit the power of a Jersey company. That being said, the Memorandum and Articles of Association should still be reviewed to ensure there are no limits on the authority of the directors to enter into the required documents.

2.4 Are any governmental or other consents or filings, or other formalities (such as shareholder approval), required?

As per the above, shareholder approval is advisable if there are corporate benefit concerns. A guarantee does not need to be registered in Jersey.

2.5 Are net worth, solvency or similar limitations imposed on the amount of a guarantee?

No, although the solvency of the company should be considered when entering into a guarantee. If a company enters into a transaction with a person for cause (similar to consideration under English law) the value of which, in money or equivalent, is significantly less than the value of the *cause* provided by that person, the transaction may be impugned as a transaction at an undervalue and challenged by (i) the Viscount of the Royal Court of Jersey (the insolvency officer of the Royal Court) (the "**Viscount**") in a *désastre* under the Bankruptcy (*Désastre*) (Jersey) Law 1990 (the "**Désastre Law**"), and (ii) by a liquidator in a creditor's winding up under the Companies Law.

A transaction may be challenged if it was entered into during the five years preceding the commencement of the *désastre* or winding up (no time limit applies to transactions involving persons connected with or an associate of the insolvent debtor).

However, a transaction is not vulnerable to attack as a transaction at an undervalue if either:

- the relevant company:
  - was able to pay its debts as they fall due at the time it entered into the transaction; and
  - did not become insolvent on a cash flow basis as a result of entering into the transaction; and/or
- the court is satisfied that both:
  - the company entered into the transaction in good faith for the purpose of carrying on its business; and
  - at the time it entered into the transaction, there were reasonable grounds for believing that the transaction would benefit the company.

2.6 Are there any exchange control or similar obstacles to enforcement of a guarantee?

If court proceedings are brought against a guarantor company, the enforceability of that company's obligations can be qualified if the following Jersey customary law rights of a surety are available to it:

- *Droit de discussion* – this is the right to require that recourse is made against the assets of the borrower and that those assets are exhausted before any claim is enforced against the guarantor.
- *Droit de division* – this is the right to require that liability of co-guarantors is divided or apportioned between them.

It is market practice for a lender to require a specific waiver of these rights.

3 Collateral Security

3.1 What types of collateral are available to secure lending obligations?

Common types of collateral that are secured are: real estate; shares; units in a unit trust; bank accounts; and contract rights.

3.2 Is it possible to give asset security by means of a general security agreement or is an agreement required in relation to each type of asset? Briefly, what is the procedure?

It is possible to take "a debenture-style" security under the Security Interests Law over all present and future intangible movable property held by the grantor in Jersey from time to time. The attachment of a security interest to collateral is not affected by the security agreement providing an express right of the grantor to deal with the collateral free from the security interest and without a duty to account for the proceeds or to replace the collateral. Jersey law does not have a concept of a floating charge. The security would be taken by way of a security interest agreement entered into under the Security Interests Law. In order for a security interest to attach to collateral (on which the security becomes enforceable against the grantor), the following conditions must be satisfied:

- Value must have been given in respect of the security agreement. Value means something sufficient to support an onerous contract, and includes an antecedent debt or liability. It does not matter to whom value is given or from whom the value arises.
- The grantor must have rights, or the power to grant rights to a secured party, in the collateral. A trustee can therefore grant valid security under the Security Interests Law.
- The secured party has possession or control of the collateral and/or the security agreement is in writing and contains a description of the collateral that is sufficient for it to be identified. Even where there is no agreement in writing, there must still be a "security agreement".

Perfection of a security interest is necessary for the purposes of priority and gives protection against third parties, which is particularly important in insolvency. The method of attachment and perfection will depend on the type of collateral secured. The three ways for the secured party to obtain perfection are:

- by possession of documentary intangibles such as negotiable instruments or bearer securities;
- by control of the collateral such as bank accounts (including security accounts) and investment securities; and/or
- by registration of a financing statement on the Jersey Security Interests Register in its favour in respect of the collateral.

3.3 Can collateral security be taken over real property (land), plant, machinery and equipment? Briefly, what is the procedure?

Security can be taken over real estate by way of (i) hypothec (for freehold and flying freehold properties (where individual parts of a property are sold for exclusive ownership)) and the hypothec can be judicial or conventional, or by way of (ii) share security (for share transfer properties where a Jersey holding company owns the freehold title to the real estate). A hypothec is a charge which can attach to freehold and flying freehold properties. Paper leases cannot be hypothecated, while contract leases can be hypothecated if the lease terms expressly permit it. Hypothecs can be specific (that is, over one property) or general (that is, attaching to all real estate that the borrower owns at the date of registration).

Share security would be taken by way of a security interest agreement entered into under the Security Interests Law.

In relation to plant, machinery and equipment, the only method of creating security over tangible movables in Jersey is by way of pledge. To pledge property there must be actual physical (as opposed to constructive) delivery of the tangible movable property pledged into the creditor's possession.

There is a right of retention. As a matter of customary law (absent any Jersey judicial authority on this point) the creditor should have an implied right of sale when the grantor is in default and there is likely to be an express power of sale in the pledge document.

3.4 Can collateral security be taken over receivables? Briefly, what is the procedure? Are debtors required to be notified of the security?

Typically, security in respect of contract rights and receivables is created by way of a security interest agreement entered into under the Security Interests Law by way of description and registration. Although it is no longer necessary to give notice to the counterparty, there are usually advantages to doing so (for example, to obtain, by way of acknowledgment to the notice a waiver of any conflicting provisions in the underlying contract and/or a confirmation that the counterparty will make payments directly to the secured party).

Common types of receivables include:

- Rent payable under a lease agreement.
- A general partner's right to call for capital from the partners of a limited partnership.
- Debts and other rights to the payment of money.
- Rights under performance contracts.
- Bank accounts into which the receivables are paid and other cash deposited with banks.

The Security Interests Law also contains specific provisions in relation to outright assignments of receivables which are defined as monetary entitlements arising from the supply of goods and services (other than insurance services) or the supply of energy.

3.5 Can collateral security be taken over cash deposited in bank accounts? Briefly, what is the procedure?

Yes, this is a common form of security taken in Jersey. The method will depend on whether the account is with the secured party or a third-party bank.

Security will be created by way of a security interest agreement under the Security Interests Law. Control would be obtained by the:

- account being transferred into the name of the secured party with the written agreement of the grantor and the account bank;
- account bank agreeing in writing to act on the secured party's instructions directing disposition of funds in the account;
- account being assigned to the secured party and written notice of such being given to the account bank; or
- account bank being the secured party.

Typically, security over third party bank accounts is taken by assignment. Although not necessary to perfect the security, it is usual to obtain an acknowledgment of the notice from the account bank, which will include, for example, a waiver of:

- Any terms and conditions which may restrict or prohibit the creation of the security.
- Its rights of set-off over the account.

3.6 Can collateral security be taken over shares in companies incorporated in your jurisdiction? Are the shares in certificated form? Can such security validly be granted under a New York or English law-governed document? Briefly, what is the procedure?

Yes, security can be taken over shares in a Jersey company in a certificated format. Security would be taken by way of a security interest agreement under the Security Interests Law. Control would be obtained by the secured party either:

- being registered as the holder of the securities; or
- having possession of the certificate representing the securities.

Security cannot be validly granted over shares in a Jersey company under a New York or English law-governed document.

3.7 Can security be taken over inventory? Briefly, what is the procedure?

Jersey law does not have a concept of a floating charge. Therefore, security over tangible movables such as inventory in Jersey would have to be taken by way of pledge. Please see question 3.3 above.

3.8 Can a company grant a security interest in order to secure its obligations (i) as a borrower under a credit facility, and (ii) as a guarantor of the obligations of other borrowers and/or guarantors of obligations under a credit facility (see below for questions relating to the giving of guarantees and financial assistance)?

Yes – a typical security package we see in Jersey is: (i) borrower grants security over any accounts it holds in Jersey; (ii) borrower's shareholder(s) grant(s) security in respect of the shares in the borrower; and (iii) the lender of any intercompany loans to the borrower grants security over those contract rights.

3.9 What are the notarisation, registration, stamp duty and other fees (whether related to property value or otherwise) in relation to security over different types of assets?

There are registration fees associated with using the securities register. These are outlined on the Registry website:

- registration – £8 per year of registration up to a maximum fee of £150 if the registration will run longer than 20 years (there is no concept of infinite registration);
- discharge – no fee;
- amendment of registration – £8;
- extension of period of registration – same cost scheme as above;
- global change of multiple registrations (other than expiry date) – £100;
- search – £4 to view a financing statement; and
- filing a change demand – £25.

Stamp duty is payable when a lender registers security over real estate situated in Jersey. Stamp duty is calculated at the rate of 0.5% of the amount of debt secured over the property in favour of the lender, plus a Court fee of £80.

Land transaction tax ("**LTT**") is payable when a lender takes security over a share transfer property situated in Jersey and is calculated at a rate of 0.5% of the amount of the debt to be secured, plus an administration fee of £80. LTT applies only in relation to residential property, where the articles of the property owning company confer rights of occupation to their shareholders.

There are no relevant notary fees.

3.10 Do the filing, notification or registration requirements in relation to security over different types of assets involve a significant amount of time or expense?

For security which is created over intangible movable property under the Security Interests Law, the registration requirements do not involve a signification amount of time or expense.

For security which is registered over Jersey immovable property, the Billet (the acknowledgment document creating a judicial hypothec) or the contract creating the charge (in the case of a simple conventional hypothec) must be registered with the Royal Court of Jersey, which can only take place on a Friday afternoon (subject to Court holidays). The stamp duty must be paid at the time of registration. Once registered, the Billet or contract (as the case may be) becomes a matter of public record.

3.11 Are any regulatory or similar consents required with respect to the creation of security?

A consent should be obtained from the grantor prior to the registration of the security interest on the Jersey Security Interests Register, pursuant to which the grantor consents to the registration and for any personal data to be publicly available.

3.12 If the borrowings to be secured are under a revolving credit facility, are there any special priority or other concerns?

The definition of secured obligations/liabilities in the security agreement should provide for further advances to ensure that the priority of the original advance will not be lost in respect of further advances.

3.13 Are there particular documentary or execution requirements (notarisation, execution under power of attorney, counterparts, deeds)?

No, there are not.

4 Financial Assistance

4.1 Are there prohibitions or restrictions on the ability of a company to guarantee and/or give security to support borrowings incurred to finance or refinance the direct or indirect acquisition of: (a) shares of the company; (b) shares of any company which directly or indirectly owns shares in the company; or (c) shares in a sister subsidiary?

(a) Shares of the company

The concept of financial assistance was abolished in Jersey in 2008. Jersey companies are not prohibited from giving financial assistance for the acquisition of their own shares. If financial assistance raises questions relating to corporate benefit, or amounts to a distribution, the relevant statutory procedures must be complied with.

(b) Shares of any company which directly or indirectly owns shares in the company

Jersey companies are not prohibited from giving financial assistance for the acquisition of shares of any company which directly or indirectly owns shares in the company. If financial assistance raises questions relating to corporate benefit, or amounts to a distribution, the relevant statutory procedures must be complied with.

(c) Shares in a sister subsidiary

Jersey companies are not prohibited from giving financial assistance for the acquisition of shares of shares in a sister subsidiary. If financial assistance raises questions relating to corporate benefit, or amounts to a distribution, the relevant statutory procedures must be complied with.

5 Syndicated Lending/Agency/Trustee/Transfers

5.1 Will your jurisdiction recognise the role of an agent or trustee and allow the agent or trustee (rather than each lender acting separately) to enforce the loan documentation and collateral security and to apply the proceeds from the collateral to the claims of all the lenders?

Jersey law recognises the concept of agency and trust relationships and accordingly an agent or trustee would be able to enforce the loan documentation and collateral security and apply the proceeds in the manner set out in the loan agreement or intercreditor agreement.

5.2 If an agent or trustee is not recognised in your jurisdiction, is an alternative mechanism available to achieve the effect referred to above which would allow one party to enforce claims on behalf of all the lenders so that individual lenders do not need to enforce their security separately?

This is not applicable.

5.3 Assume a loan is made to a company organised under the laws of your jurisdiction and guaranteed by a guarantor organised under the laws of your jurisdiction. If such loan is transferred by Lender A to Lender B, are there any special requirements necessary to make the loan and guarantee enforceable by Lender B?

The transfer provisions will usually be set out in the loan agreement and guarantee and these should be complied with.

If there are no such transfer provisions, the benefit of the loan and the guarantee should be validly assigned to Lender B in order to ensure that the guarantee is enforceable by Lender B. For completeness, notice of the assignment should be given to the company and the guarantor. If the loan is not fully utilised and Lender A was under an obligation to make further advances, the loan would require to be novated as opposed to transferred. If the loan is not novated to Lender B this could have implications on the enforceability of the guarantee.

6 Withholding, Stamp and Other Taxes; Notarial and Other Costs

6.1 Are there any requirements to deduct or withhold tax from (a) interest payable on loans made to domestic or foreign lenders, or (b) the proceeds of a claim under a guarantee or the proceeds of enforcing security?

No, there are not.

6.2 What tax incentives or other incentives are provided preferentially to foreign lenders? What taxes apply to foreign lenders with respect to their loans, mortgages or other security documents, either for the purposes of effectiveness or registration?

Foreign lenders do not receive preferential tax treatment when compared to Jersey lenders. However, Jersey can generally ensure tax neutrality, and avoidance of double taxation.

6.3 Will any income of a foreign lender become taxable in your jurisdiction solely because of a loan to, or guarantee and/or grant of, security from a company in your jurisdiction?

No, it will not.

6.4 Will there be any other significant costs which would be incurred by foreign lenders in the grant of such loan/guarantee/security, such as notarial fees, etc.?

Please see questions 3.9 and 3.10 above.

6.5 Are there any adverse consequences for a company that is a borrower (such as under thin capitalisation principles) if some or all of the lenders are organised under the laws of a jurisdiction other than your own? Please disregard withholding tax concerns for purposes of this question.

No, there are not.

7 Judicial Enforcement

7.1 Will the courts in your jurisdiction recognise a governing law in a contract that is the law of another jurisdiction (a "foreign governing law")? Will courts in your jurisdiction enforce a contract that has a foreign governing law?

The courts in Jersey will recognise a foreign governing law provided it is a valid choice of law for the issue in question upon proof of the relevant provisions of the governing law.

7.2 Will the courts in your jurisdiction recognise and enforce a judgment given against a company in New York courts or English courts (a "foreign judgment") without re-examination of the merits of the case?

The enforcement of foreign judgments is governed by the Judgments (Reciprocal Enforcement) (Jersey) Law 1960. If a final and conclusive judgment under which a sum of money is payable (not being a sum payable in respect of taxes or other charges of a like nature or in respect of a fine or other penalty) were obtained in a Reciprocal Enforcement Court (as defined below) having jurisdiction in a case against a company, such judgment would, on application to the Royal Court of Jersey, be registered without reconsidering its merits and would thereafter be enforceable.

The Reciprocal Enforcement Courts means the following superior courts: (a) in England and Wales, the Supreme Court of the United Kingdom, the Court of Appeal and the High Court of Justice; (b) in Scotland, the Supreme Court of the United Kingdom, the Court of Session and the Sheriff Court; (c) in Northern Ireland, the Supreme Court of the United Kingdom and the Court of Judicature of Northern Ireland; (d) in the Isle of Man, Her Majesty's High Court of Justice of the Isle of Man (including the Staff of Government/Appeal Division); and (e) in Guernsey, the Royal Court of Guernsey and the Court of Appeal of Guernsey. The creditor of such a judgment must apply to have it enforced in Jersey within six years from the date the decision is handed down, or the date of the judgment on the last appeal. Such registration will not require the consideration of the merits of a case.

Where the above law does not apply, including New York judgments, foreign judgments will be recognised at customary/common law. Subject to the principles of private international law, by which for example foreign judgments may be impeachable, as applied by Jersey law (which are broadly similar to the principles applied under the common law rules of England), if a Foreign Judgment (as defined below) were obtained the judgment creditor must begin a fresh action in the Royal Court of Jersey, relying on the unsatisfied Foreign Judgment as a cause of action. The matter will usually be determined summarily without a full trial. The judgment debtor can oppose the application for summary judgment and/or defend the claim, but there are only limited grounds on which enforcement will be refused and a full factual enquiry is rarely necessary.

The grounds for refusing to enforce a judgment are substantially similar to the grounds on which registration can be set aside (i.e the foreign court had no jurisdiction, or there were procedural inadequacies in obtaining the Foreign Judgment). If the court is satisfied that the judgment must be enforced, it will be entered in favour of the judgment creditor and be enforceable in Jersey as a domestic judgment.

7.3 Assuming a company is in payment default under a loan agreement or a guarantee agreement and has no legal defence to payment, approximately how long would it take for a foreign lender to (a) assuming the answer to question 7.1 is yes, file a suit against the company in a court in your jurisdiction, obtain a judgment, and enforce the judgment against the assets of the company, and (b) assuming the answer to question 7.2 is yes, enforce a foreign judgment in a court in your jurisdiction against the assets of the company?

(a) Proceedings in respect of a debt for a liquidated sum can be commenced by way of a simple summons, which can be prepared and served within a few days. The summons must be served four clear days before the return date to which the company is summoned. If the company does not attend at the return date, judgment in default can be obtained (i.e. in as quickly as two weeks).

If the company defends the claim, the Royal Court of Jersey will place the action on the pending list (effective immediately). An application for summary judgment can be brought at this time, which we expect could be heard and determined within 4–6 weeks.

If the application for summary judgment is defended, and is unsuccessful, the matter would proceed to a trial and could take up to one year for it to be heard and a subsequent judgment to be issued.

The length of time to effect enforcement depends on the process used.

A monetary judgment is immediately enforceable by distraint against the judgment debtor's assets. The Viscount will take possession of and effect a sale of the debtor's assets and apply the proceeds in satisfaction of the judgment, subject to certain notification requirements. The timing of this process depends on the Viscount's availability and the number of assets to be dealt with.

If the debtor owns property in Jersey, orders can be sought one month following the issue of a court judgment (provided it remains unsatisfied), for an "*Acte Vicomte chargé d'écrire*". The effect of this declaration is that if the judgment is not satisfied within a further two months, the debtor's property will be deemed to have been renounced. At that time a creditor can seek orders for "*dégrèvement*" (for immovable property) and "*réalisation*" (for movable property). The timing of either of these enforcement processes once commenced is difficult to ascertain as once orders are made, the sale and dealing of the assets is conducted by the *Attournées*. However, we generally understand that, from the making of an order, a *dégrèvement* process (including the hearing) may take approximately four to six weeks. Following the hearing the creditor who elects to take the property, subject to claims of superior lenders, will be immediately entitled to the asset. The timeframe for a *réalisation* may take approximately two to three months depending on the liquidity of the assets.

An application can also be made by a creditor of a company with a liquidated claim exceeding £3,000 that the company be declared *en désastre* as it is unable to pay its debts as it falls due (please also see question 8.4). Such an application can be made quickly without notice to the debtor usually on no more than 48 hours' notice to the Court. If a declaration is made by the Royal Court of Jersey, and after a one month period within which the debtor can object has expired, the Viscount will begin the process of collecting in the debtor's assets and distributing them to all creditors on the basis of a statutory waterfall. It is difficult to give an estimate to the Viscount's process, but typically a creditor can expect this to take no less than six months.

(b) Once a foreign judgment is registered in Jersey, the creditor must serve a notice of registration on the debtor providing the timeframe (generally 14 or 28 days) within which the debtor may apply to have the registration set aside. Once the time for challenging registration has passed, the foreign judgment is enforceable from that point on in the same way as a domestic judgment.

7.4 With respect to enforcing collateral security, are there any significant restrictions which may impact the timing and value of enforcement, such as (a) a requirement for a public auction, or (b) regulatory consents?

There is no requirement for a public auction in relation to the enforcement of security granted under the Security Interests Law. Generally speaking, enforcement does not require consent from the Viscount or an order from a court. Please also see question 8.4 in relation to enforcement of security.

However, enforcement of security over real estate in Jersey (see question 8.4 for further detail), will involve the Royal Court of Jersey and the Viscount and will be subject to the requirements of Article 27 of the Désastre Law which provides that the Viscount may sell the property by public auction or public tender.

7.5 Do restrictions apply to foreign lenders in the event of (a) filing suit against a company in your jurisdiction, or (b) foreclosure on collateral security?

No restrictions apply to foreign lenders beyond those which apply to Jersey lenders.

7.6 Do the bankruptcy, reorganisation or similar laws in your jurisdiction provide for any kind of moratorium on enforcement of lender claims? If so, does the moratorium apply to the enforcement of collateral security?

Pursuant to Article 10 of the Désastre Law there is a statutory moratorium on actions and enforcement, with effect from the date of the declaration of *en désastre*. Legal/enforcement action may only be commenced or continued with consent of the Viscount or by order of the Court. If the creditor is a company, any transfer of shares not made with the sanction of the Viscount or any alteration in the status of the company's members which is made after the declaration is void.

However, a secured party under the Security Interests Law is not prevented from exercising a power under Part 7 of the Security Interests Law in relation to the relevant collateral, including appropriating or selling shares. No consent of the Viscount or order of the Court is required.

7.7 Will the courts in your jurisdiction recognise and enforce an arbitral award given against the company without re-examination of the merits?

Arbitration is rarely used as a method of commercial dispute resolution in Jersey. However, domestic arbitral awards are enforceable in Jersey with leave of the court under The Arbitration (Jersey) Law 1998 (the "**Arbitration Law**").

In addition to the domestic procedure above, the Arbitration Law provides that a foreign arbitral award handed down in a country that is a signatory to the New York Convention on the Recognition and Enforcement of Foreign Arbitral Awards 1958 (the "**New York Convention**") is enforceable as if it were a domestic arbitral award.

Further, other foreign awards from certain non-New York Convention states may also be enforceable under the Arbitration Law if the state in question is a signatory to the Geneva Convention on the Execution of Foreign Arbitral Awards 1927 in the same way as a domestic award or "by action".

Such awards must meet certain standards. They are recognised if the arbitration:

a) was made pursuant to an agreement for arbitration that was valid under the law by which it is governed;

b) was made by the tribunal provided for in the agreement or constituted in a manner agreed by the parties;

c) was made in conformity with the relevant law governing arbitration;

d) is final in the relevant jurisdiction;

e) conforms to the definition of arbitration under Jersey law; and

f) the enforcement of which would not be contrary to the law, or public policy of Jersey.

8 Bankruptcy Proceedings

8.1 How does a bankruptcy proceeding in respect of a company affect the ability of a lender to enforce its rights as a secured party over the collateral security?

In the event of a declaration of *en désastre* under Article 3 of the Désastre Law, the property and powers of a company vest in the Viscount and no further enforcement action may be taken against the company in respect of debts which are provable in a *désastre*. In the case of a creditors' winding up under Chapter 4 of Part 21 of the Companies Law, although there is no vesting, the liquidator has similar powers to the Viscount and the Companies Law provides that after commencement of the creditors' winding up, no further action shall be taken or proceeded with against the company except by leave of the court.

Notwithstanding the above, the Security Interests Law operates to allow a secured party to exercise a power of enforcement under the Security Interests Law in relation to the relevant collateral without the consent of the Viscount, and without an order of a Court, so that a secured party's powers to appropriate or sell the collateral will not be affected by the insolvency.

Nevertheless, the powers to set aside transactions at an undervalue and preferences still apply. A security interest will be void against the Viscount or a liquidator and the company's creditors, if it is not perfected before the grantor becomes bankrupt.

8.2 Are there any preference periods, clawback rights or other preferential creditors' rights (e.g., tax debts, employees' claims) with respect to the security?

Under the Security Interests Law, a secured party with a perfected security interest has priority over any other creditor. If the secured party has sold or appropriated the collateral and the net value or proceeds of sale (as appropriate) of the collateral exceeds the amount of the debt owed to the secured party, the secured party must pay the amount of any resulting surplus in the following order:

- Any person who has a subordinate security interest in the collateral and has registered a financing statement over that security interest (where the registration remained effective immediately before the appropriation or sale).
- Any other person (other than the grantor) who has given the secured party notice that that person claims an interest in the collateral, and in respect of which the secured party is satisfied that that person has a legally enforceable interest in the collateral.
- The grantor.

Under the Security Interests (Jersey) Law 1983 (the "**1983 Security Interests Law**"), the secured party must apply the proceeds of sale in the following order:

- Payment of the costs and expenses of the sale.
- Discharge of any prior security interest.
- Discharge of all monies properly due in relation to the obligation secured by the security agreement.
- Payment, in due order of priority, of the secured parties whose security interests were created after those being enforced under the security agreement.
- In relation to the balance (if any remains), payment to the grantor or, if the grantor is bankrupt or is subject to any other judicial arrangement due to its insolvency, to the Viscount, receiver or other proper officer.

  Money or monies in a bank account must be applied under the 1983 Security Interests Law as if they were proceeds of sale.

  If more than one creditor holds the same security interest (and each security interest is created under the Security Interests Law 1983) over the same asset, priority is determined by the date of creation of the security interest.

As stated above, if a declaration for *en désastre* is made, a secured party under the Security Interests Law is entitled to enforce their security over the collateral, which will not fall into the *désastre* estate. Once this has occurred, any surplus will fall into the *désastre* estate to be dealt with by the Viscount in the usual way.

Creditors who hold a judicial or conventional hypothec registered against real estate are entitled to a preference over the proceeds of sale of any property on which their charge is secured. If there are a number of registered hypothec, preference is determined by the date of creation. This is not subject to any other preference or clawback rights. Where the asset owner has been declared *en désastre*, the collateral will fall into the *désastre* estate and the Viscount will take the collateral subject to the hypothec.

8.3 Are there any entities that are excluded from bankruptcy proceedings and, if so, what is the applicable legislation?

The Désastre Law sets out the persons in respect of whose property an *en désastre* declaration can be made, and includes any person:

a) who is, or was, at any time within the period of 12 months immediately preceding the date of the application, ordinarily resident in Jersey;
b) who carries on, or has carried on, at any time within the period of three years immediately preceding the date of the application, business in Jersey, whether or not they are domiciled in Jersey;
c) who has in Jersey immovable property capable of realisation at the time of the application;
d) who, being a company, is registered under the Companies Law or has been dissolved pursuant to that Law;
e) who is an incorporated limited partnership; or
f) who is a limited liability partnership,

whether or not the debtor is present in Jersey at the time of application for a declaration or at the time of the declaration.

No *en désastre* declaration may be made in respect of:

- Separate limited partnerships.
- Limited partnerships.

It is not clear as a matter of Jersey law whether or not the assets of a trustee as trustee of a trust can be declared *en désastre*. We are not aware of any instance in which such a declaration has been made. If, however, the assets of a trustee were declared *en désastre* and in the event that any document was held by the Jersey courts to constitute a transaction at an undervalue and/or the giving of a preference to any person, the Jersey courts would have the power, depending, *inter alia*, on the period of time elapsed since the transaction was entered into, to set aside such transaction.

8.4 Are there any processes other than court proceedings that are available to a creditor to seize the assets of a company in an enforcement?

Security agreements over intangible movable property other than cash created under the Security Interests Law.

The Security Interests Law allows a secured party to enforce by way of sale or appropriation of the collateral or proceeds. In addition, the secured party can take any of the following ancillary actions for the purpose of effecting a sale or appropriation:

- Take control or possession of the collateral or proceeds.
- Exercise any of the rights of the grantor in relation to the collateral or proceeds.
- Instruct any person who has an obligation in relation to the collateral or proceeds to carry out the obligation for the benefit of the secured party (for example, directing the actions of an intermediary who holds a securities account for the grantor).
- Apply any remedy that the security agreement provides for as a remedy that is exercisable pursuant to the power of enforcement, to the extent that it does not conflict with the Security Interests Law. Bespoke enforcement powers can therefore be included as appropriate to the collateral secured.

More than one enforcement option can be taken, and taking one or more of the enforcement options specified above does not preclude the exercise of other rights of the secured party.

The power of enforcement is exercisable once an event of default has occurred and written notice specifying the event of default has been served on the grantor by the secured party.

If enforcement is by way of sale or appropriation, the secured party must give the grantor 14 days' prior written notice. Importantly, in contrast to the 1983 Security Interests Law, the grantor can agree in writing (typically in the security agreement) to waive its right to notice of appropriation or sale.

The secured party is obliged on sale or appropriation, to give at least 14 days' prior written notice to any person who, 21 days before the sale or appropriation, has a registered security interest in the collateral, or any person other than the grantor who has an interest in the collateral.

There are specific carve-outs from the obligation to give notice, to the extent, for example, that the security property is a quoted investment security.

Self-sale is now expressly permitted.

On appropriation or sale, the secured party must:

- Take all commercially reasonable steps to determine or, in the case of a sale, obtain the fair market value of the collateral, as at the time of the relevant appropriation or sale.
- Act in a commercially reasonable manner in relation to the appropriation or sale.
- In the case of a sale, enter into any agreement for or in relation to the sale on commercially reasonable terms.

The duty of the secured party is owed to the grantor and also to any other person to whom the secured party was required to give notice of appropriation or sale.

If, in exercising its powers of enforcement, a secured party appropriates or sells collateral, it must, within the 14 days after the day on which the collateral is appropriated or sold, give a written statement of account setting out certain information in relation to that appropriation or sale to:

- The grantor (subject to it having waived this requirement).
- Any person with a registered subordinate security interest.
- Any person claiming an interest in the collateral.

If, in exercising its powers of enforcement, a secured party appropriates or sells collateral, it must pay to certain specified persons the amount of any resulting surplus by satisfying the claims of those persons in the prescribed order or alternatively can pay any amount of resulting surplus into the Royal Court of Jersey.

Security agreements under the 1983 Security Interests Law.

For security created under and governed by the 1983 Security Interests Law, a power of sale is the only specified means of enforcement (other than in relation to cash or a negotiable instrument, which can be appropriated). A secured party's ability to enforce its security by a contractual mechanism is untested in the courts, but is often provided for in security agreements.

The power of sale can be exercised after the occurrence of a default event under the security agreement. The secured party must:

- Serve notice of default on the grantor.
- Require the grantor to remedy the default (if the grantor is capable of it).

If the grantor fails to remedy the default within 14 days after notice, the power of sale becomes exercisable.

- The secured party must take all reasonable steps to ensure that the sale is made both:
  - Within a reasonable time.
  - For a price corresponding to the value on the open market at the time of sale of the collateral being sold.

Real estate

A secured creditor can enforce against Jersey real estate through either of the following:

Dégrèvement. A particular immovable has its encumbrances removed so that a creditor can take it free and clear of all charges. It is a bankruptcy for the purposes of Jersey law:

- The process is complicated and is carried out under the 1880 law on immovable property. It can only be commenced by a secured creditor and results in one creditor keeping the property.
- The creditor taking the property must pay off all earlier charges on the property. The creditor is not required to pay or return to the debtor any difference between the value of the property and the level of his claim or charge by which he has taken. If a secured creditor does not take the property when required to in accordance with the date of his charge, he loses his charge and becomes an unsecured creditor.

Désastre. The entire property of the debtor is declared *en désastre*. This is a formal declaration of bankruptcy under Jersey law. It can be commenced by the debtor or by a creditor with a liquidated claim of £3,000 or more. All of the debtor's property vests in the Viscount. The Viscount must get in and distribute all of the debtor's assets for the creditors' benefit. This includes immovables (real property). On realisation of any immovables, creditors with security are paid under their security before any amounts left over go into the bankrupt estate.

There is no equivalent to the English law concept of administration.

In certain circumstances, the Courts of Jersey can permit a solvent or insolvent company which has not been declared *en désastre,* to be wound up if it is of the opinion that either it is:

- Just and equitable.
- Expedient in the public interest.

The application to the court on these grounds can be made by the Jersey company (or its directors or shareholders) and certain government and regulatory officials.

9 Jurisdiction and Waiver of Immunity

9.1 Is a party's submission to a foreign jurisdiction legally binding and enforceable under the laws of your jurisdiction?

Please see questions 7.1 and 7.2 above.

9.2 Is a party's waiver of sovereign immunity legally binding and enforceable under the laws of your jurisdiction?

Yes, it is.

10 Licensing

10.1 What are the licensing and other eligibility requirements in your jurisdiction for lenders to a company in your jurisdiction, if any? Are these licensing and eligibility requirements different for a "foreign" lender (i.e. a lender that is not located in your jurisdiction)? In connection with any such requirements, is a distinction made under the laws of your jurisdiction between a lender that is a bank *versus* a lender that is a non-bank? If there are such requirements in your jurisdiction, what are the consequences for a lender that has not satisfied such requirements but has nonetheless made a loan to a company in your jurisdiction? What are the licensing and other eligibility requirements in your jurisdiction for an agent under a syndicated facility for lenders to a company in your jurisdiction?

There are no licensing requirements in Jersey for foreign lenders lending to a Jersey company.

If a lender carries on business in Jersey or is a Jersey company it will be subject to the Proceeds of Crime (Jersey) Law 1999. Under the Proceeds of Crime (Supervisory Bodies) (Jersey) Law 2008, if the lender does not have a registered service provider in Jersey, it may need to apply to be registered with the Jersey Financial Services Commission (the "**JFSC**") to be supervised in relation to its compliance with relevant anti-money laundering and counter-terrorism legislation. Whether or not a lender requires to apply to be registered with the JFSC to be supervised, it is required to comply with relevant anti-money laundering and counter-terrorism legislation.

11 Other Matters

11.1 Are there any other material considerations which should be taken into account by lenders when participating in financings in your jurisdiction?

Jersey is a politically stable and fiscally advantageous financial centre which has has been at the forefront of the global finance industry for over 50 years. The Island enjoys economic stability, political independence, tax neutrality and sophisticated legal, regulatory and technological infrastructure. It has a global reputation founded on a robust legal framework and sound corporate governance practices.

Jersey's evolution as an international finance centre is founded on its close ties to the City of London and its growth as a jurisdiction of choice in the European as well as Middle Eastern, North American and Asian markets.

In 2016, the Financial Action Task Force ("**FATF**") confirmed that Jersey is compliant or largely compliant with 48/49 of the FATF recommendations in respect to anti-money laundering and combating the financing of terrorism. In 2017, Standard & Poor's confirmed Jersey's credit as AA-, one of the highest possible ratings.

The International Stock Exchange offers an efficient listing service and has received a number of international recognitions making it an attractive and increasingly popular option for listing debt securities.

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Robin is consistently recognised for his ability to deal with a wide range of international corporate and finance transactions. He has acted on numerous significant portfolio acquisitions and disposals. He often acts for both lenders and borrowers on complex financings, refinancings and restructurings and has significant experience in relation to the financing of investment funds.

Robin advises global banks and large corporates as well as smaller privately held entities. Robin regularly establishes new Jersey structures, including corporates, limited partnerships and unit trusts. He also has experience advising in relation to the establishment, transfer and redomiciliation of banking business in Jersey.

Robin is a director of Carey Olsen Corporate Finance Limited which provides sponsor services in respect of The International Stock Exchange listings and regularly advises on transactions involving Eurobonds and other TISE listed securities.

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Laura acts on a wide range of banking, real estate finance, corporate finance and fund finance matters. She specialises in advising international financial institutions and corporate borrowers in relation to real estate finance transactions and funds finance transactions involving Jersey structures.

Laura has experience of acting on a number of high-value and multi-jurisdictional transactions.

CAREY OLSEN

Carey Olsen is a leading offshore law firm. We advise on Bermuda, British Virgin Islands, Cayman Islands, Guernsey and Jersey law across a global network of nine international offices.

We are a full-service law firm working across banking and finance, corporate and M&A, investment funds and private equity, trusts and private wealth, dispute resolution, insolvency and property law.

We work alongside all of the major onshore law firms, accountancy firms and insolvency practitioners on corporate transactions and matters involving our jurisdictions.

Our advice is delivered by an approachable and experienced team of globally-minded lawyers who work in partnership with our clients to help them achieve their objectives. We have the expertise and resources to handle the most complex international transactions combined with a personal approach to business.

Luxembourg

Loyens & Loeff Luxembourg S.à r.l.

Antoine Fortier-Grethen

1 Overview

1.1 What are the main trends/significant developments in the lending markets in your jurisdiction?

In the last year, we have seen an increase in facility arrangements with limited covenants and obligations, as well as more debt restructurings. The market seems to be more borrower-friendly and sponsor-led than in past years. In addition, Luxembourg has benefited from a steady growth in the funds market. Fund financing has confirmed its emergence as an important market in Luxembourg.

1.2 What are some significant lending transactions that have taken place in your jurisdiction in recent years?

Luxembourg has been a truly active jurisdiction for lending transactions over the last few years and remains a hub for many acquisition financings. One of the recent major deals was the USD 1,500,000,000 financing of Ternium Investments S.à r.l. for the acquisition of Thyssenkrupp Slab International B.V. and its subsidiary CSA Siderúrgica do Atlântico Ltda. The financing by Elliott Management of Rossoneri Sport Investment Lux in relation to the acquisition of the Italian football club AC Milan is also one of the recent highlights. The transaction is the largest deal in the football sector in the last few years.

2 Guarantees

2.1 Can a company guarantee borrowings of one or more other members of its corporate group (see below for questions relating to fraudulent transfer/financial assistance)?

There is no legislation in Luxembourg which specifically regulates the establishment, organisation and liability of groups of companies. Consequently, the concept of group interest as opposed to the interest of an individual corporate entity is not expressly recognised.

To the extent permitted by its corporate object, a Luxembourg company may provide guarantees in favour of group companies in general. Where a Luxembourg company provides upstream or cross-stream guarantees for the obligations of its parent companies or sister companies, certain corporate benefit issues may arise (please see question 2.2 for further details).

2.2 Are there enforceability or other concerns (such as director liability) if only a disproportionately small (or no) benefit to the guaranteeing/securing company can be shown?

The guaranteeing company must act in its own corporate interest (*intérêt social*), i.e. derive a certain benefit from the transaction.

Whether a guarantee is in the corporate interest of a company is ultimately a matter of fact. The management body of the company is responsible for this determination, which is made on a case-by-case basis, depending, for instance, on the arm's length conditions of the guarantee, and on any remuneration or benefit received by the guarantor.

A guarantee which is considered by a Luxembourg court as a misappropriation of corporate assets (*abus de biens sociaux*) or in respect of which it could be shown that the other parties to the transaction were, or should have been, aware of the absence of corporate interest, can be nullified or declared void on the ground of illegal cause (*cause illicite*) and result in the liability of the directors/managers of the company.

2.3 Is lack of corporate power an issue?

Yes. In principle, a company is bound towards third parties by any acts of its management body or persons authorised to bind the company, even if such acts exceed the corporate object (*ultra vires*), unless it proves that the third party knew that the act exceeded the corporate object or could not, in view of the circumstances, have been unaware of it, without the mere publication of the articles of association being sufficient to constitute such proof. It does not impact enforceability (mandate apparent).

2.4 Are any governmental or other consents or filings, or other formalities (such as shareholder approval), required?

There are no governmental or other consents or filings required to grant and perfect a guarantee, unless the guarantee is granted by a regulated entity. The guarantee may need to be approved by the company's relevant management body. No shareholder approval is in principle required (unless the articles of association of the company state otherwise).

2.5 Are net worth, solvency or similar limitations imposed on the amount of a guarantee?

To the extent the granting of the guarantee is in the corporate interest (*intérêt social*) of the guarantor (see question 2.2), no net worth, solvency or similar limitations would apply, but in practice, in case of an upstream or cross-stream guarantee, the amount of the guarantee is often limited to a percentage of the own funds (*capitaux propres*) of the guarantor.

2.6 Are there any exchange control or similar obstacles to enforcement of a guarantee?

There are no exchange controls in force that could prevent any repatriation of realisation proceeds or other payments to a beneficiary of a guarantee.

3 Collateral Security

3.1 What types of collateral are available to secure lending obligations?

Financial collateral arrangements (*contrats de garantie financière*) (in particular pledges or assignments by way of security) governed by the Luxembourg law on financial collateral arrangements dated 5 August 2005, as amended (the **Collateral Law**), are the most commonly used form of security.

A mortgage (*hypothèque*) is the most common form of security over real property.

Less common types of security include civil pledges (*gage civil*), commercial pledges (*gage commercial*) and pledges over an ongoing business concern (*gage sur fonds de commerce*) (see question 3.3).

3.2 Is it possible to give asset security by means of a general security agreement or is an agreement required in relation to each type of asset? Briefly, what is the procedure?

Apart from a pledge over an ongoing business concern (*gage sur fonds de commerce*), Luxembourg law does not provide for an all-asset security interest (i.e. floating charge). Security is typically granted on an asset-by-asset basis, where shares, receivables or bank accounts are concerned and the procedure for creating such security depends on the type of asset to be encumbered.

3.3 Can collateral security be taken over real property (land), plant, machinery and equipment? Briefly, what is the procedure?

Real property – Security over real property may be created by way of a mortgage drawn up in a notarial deed. The mortgage deed must be registered with the tax administration (*Administration de l'Enregistrement et des Domaines*) and with the mortgage office (*Bureau de la Conservation des Hypothèques*) of the judicial district where the real property is located.

Machinery and equipment – Machinery and equipment is most commonly subject to a pledge over an ongoing business concern (*gage sur fonds de commerce*). Such pledge may be created either by virtue of a private or notarial deed, and only for the benefit of certain authorised credit institutions and breweries. The mortgage deed must be registered with the tax administration (*Administration de l'Enregistrement et des Domaines*) and with the mortgage office (*Bureau de la Conservation des Hypothèques*) of the judicial district in which the business is located.

As an alternative, a security interest over machinery and equipment may be created by way of a possessory pledge governed by the Commercial Code (the **CC**). The possessory pledge does not need to be formalised in a written agreement but can be established by transfer of possession, or through a contract between the parties or any means permitted by the CC.

Mortgages and pledges over an ongoing business concern are valid for 10 years following the date of their inscription with the mortgage office (which require renewal to remain valid after this period).

3.4 Can collateral security be taken over receivables? Briefly, what is the procedure? Are debtors required to be notified of the security?

Yes. Receivables may be subject to a pledge or an assignment for security purposes governed by the Collateral Law or be part of a pledge over an ongoing business concern (see question 3.3).

Pledges/assignments for security purposes must be evidenced in writing. Such security interests are fully recognised and enforceable under Luxembourg law even if they have not been notified to the debtor. The debtor of the pledged/assigned receivable will be, however, validly discharged from its obligation *vis-à-vis* the security provider if it had no knowledge of the pledge/assignment.

Since Regulation (EC) No 593/2008 of 17 June 2008 on the law applicable to contractual obligations does not explicitly provide for any conflict of law rules in relation to the enforceability and invocability of a pledge over receivables against third parties, certain Luxembourg legal practitioners consider that the pledge would become invocable against third parties (other than the debtor) if the legal formalities applicable in the jurisdiction of the debtor are duly complied with.

3.5 Can collateral security be taken over cash deposited in bank accounts? Briefly, what is the procedure?

Yes. Security over cash deposited in bank accounts (held in Luxembourg) may be created by way of a pledge governed by the Collateral Law. The pledge agreement must be evidenced in writing. Account banks typically benefit from a first ranking pledge over the account arising from their general terms and conditions. The existence of the pledge must therefore be notified to, and accepted by, the account bank.

3.6 Can collateral security be taken over shares in companies incorporated in your jurisdiction? Are the shares in certificated form? Can such security validly be granted under a New York or English law-governed document? Briefly, what is the procedure?

Yes, shares in Luxembourg companies can be subject to pledges/assignments for security purposes governed by the Collateral Law. Pledges/assignments for security purposes must be evidenced in writing. The applicable perfection formalities depend on the type of shares. Shares can be in registered form, bearer form or in dematerialised form.

Commonly, shares issued by a Luxembourg company are in registered form. In such case, the security interest will be perfected by the recording of the pledge in the register of shareholders of the company. Pledges over shares in dematerialised form require the recording in an account (for book-entry financial instruments, including dematerialised securities) or the execution of an agreement by the parties (for financial instruments other than those in book-entry form).

According to Luxembourg conflict of law rules, Luxembourg courts will generally apply the *lex loci rei sitae* or *lex situs* (the law of the place where the asset or subject matter of the security interest is located) regarding the creation, perfection and enforcement of such security interest. Thus, Luxembourg law will govern the creation, perfection and enforcement of security interests over shares issued by a Luxembourg company.

This does not completely exclude Luxembourg shares being subject to foreign security, but such security would have to comply with the Luxembourg creation, perfection and enforcement requirements.

3.7 Can security be taken over inventory? Briefly, what is the procedure?

Yes, see question 3.3.

3.8 Can a company grant a security interest in order to secure its obligations (i) as a borrower under a credit facility, and (ii) as a guarantor of the obligations of other borrowers and/or guarantors of obligations under a credit facility (see below for questions relating to the giving of guarantees and financial assistance)?

Yes, provided that the security interest granted by the company falls within its corporate object and is in its corporate interest (please see questions 2.1 and 2.2).

3.9 What are the notarisation, registration, stamp duty and other fees (whether related to property value or otherwise) in relation to security over different types of assets?

No stamp or registration duties are payable, and no notarisation or other similar formalities are required for the entry into pledges and assignments for security purposes over financial instruments/claims (e.g. shares, receivables or bank accounts) falling within the scope of the Collateral Law.

To have legal effect, a mortgage deed or a pledge over an ongoing business concern must be registered with the Luxembourg mortgage office. Mortgages and pledges over an ongoing business concern must also be registered with the tax administration, which triggers an *ad valorem* registration duty (*droit d'enregistrement*) of 0.24% on the underlying obligation for which the mortgage or pledge is given. In addition, an *ad valorem* inscription duty (*droit d'inscription*) of 0.05%, notaries' fees and mortgage keepers' fees are payable.

3.10 Do the filing, notification or registration requirements in relation to security over different types of assets involve a significant amount of time or expense?

The perfection of security interests over shares, accounts or receivables is a straightforward process which does not trigger any registration costs. The acceptance of the account pledge by the account bank may, however, take up to a few days, depending on the account bank (see question 3.5).

Generally speaking, two to three weeks are necessary to create and register a mortgage over real estate. Prior lien searches must be carried out by the notary. See question 3.9 for expenses involved.

The approval procedure by the Luxembourg government regarding a new pledgee for the creation of a pledge over an ongoing business concern may take between one to several months. See question 3.9 for the expenses involved.

3.11 Are any regulatory or similar consents required with respect to the creation of security?

Generally speaking, no regulatory consent is required, except for security provided by and sometimes over a regulated entity.

3.12 If the borrowings to be secured are under a revolving credit facility, are there any special priority or other concerns?

There are no special priority or other concerns.

3.13 Are there particular documentary or execution requirements (notarisation, execution under power of attorney, counterparts, deeds)?

No, except for mortgage deeds (real estate, aircraft, etc.) and pledges over an ongoing business concern, which are subject to notarisation (see question 3.3).

4 Financial Assistance

4.1 Are there prohibitions or restrictions on the ability of a company to guarantee and/or give security to support borrowings incurred to finance or refinance the direct or indirect acquisition of: (a) shares of the company; (b) shares of any company which directly or indirectly owns shares in the company; or (c) shares in a sister subsidiary?

Certain Luxembourg companies (such as public limited liability companies – S.A. or partnerships limited by shares – S.C.A.) may only advance funds, make loans or provide security interests, directly or indirectly, with a view to the acquisition of their own shares by a third party, if certain conditions ("white-wash") – rarely used in practice, detailed in the law of 10 August 1915 on commercial companies, as amended, (the **Company Law**) – are met. Unlawful financial assistance may result in the security interest being void and trigger the civil/criminal liability of the company's directors.

The financial assistance prohibition is generally considered not applicable to private limited liability companies (SARLs), even if the unfortunate residual drafting of the law has led to some discussions on the matter among practitioners.

This prohibition does not apply to direct or indirect shareholder(s) of the target company or sister subsidiaries.

5 Syndicated Lending/Agency/Trustee/Transfers

5.1 Will your jurisdiction recognise the role of an agent or trustee and allow the agent or trustee (rather than each lender acting separately) to enforce the loan documentation and collateral security and to apply the proceeds from the collateral to the claims of all the lenders?

Security governed by the Collateral Law may be granted in favour of a person acting for the account of the beneficiaries of the collateral, a trustee or, under certain conditions, a fiduciary, to secure the claims of third party beneficiaries.

Luxembourg law does not contain similar provisions for security interest over other assets (see question 5.2).

5.2 If an agent or trustee is not recognised in your jurisdiction, is an alternative mechanism available to achieve the effect referred to above which would allow one party to enforce claims on behalf of all the lenders so that individual lenders do not need to enforce their security separately?

Luxembourg law does not contain any similar provisions as to those described in question 5.1 above for security interests over assets other than financial instruments and claims falling within the scope of the Collateral Law.

There is some uncertainty as to whether a security over movable or immovable property may be granted to a security trustee. For this reason, a parallel debt structure is used in practice but remains untested in court.

5.3 Assume a loan is made to a company organised under the laws of your jurisdiction and guaranteed by a guarantor organised under the laws of your jurisdiction. If such loan is transferred by Lender A to Lender B, are there any special requirements necessary to make the loan and guarantee enforceable by Lender B?

Transfers of loans do not require specific formalities to be valid against a Luxembourg debtor or a Luxembourg guarantor. However, the transfer will only be enforceable against the debtor and any third parties if the debtor has been notified of, or has accepted, the transfer.

Luxembourg law security interests or suretyship, as accessories to the loan, will automatically follow the main obligation. It is, however, common practice to require the relevant grantor to confirm such security interest or guarantee upon transfer. In case of transfer by way of novation, the security interests or guarantee shall also be preserved for the benefit of the relevant secured parties.

The benefit of the pledge over an ongoing business concern may not be transferred to non-approved credit institutions (or breweries).

6 Withholding, Stamp and Other Taxes; Notarial and Other Costs

6.1 Are there any requirements to deduct or withhold tax from (a) interest payable on loans made to domestic or foreign lenders, or (b) the proceeds of a claim under a guarantee or the proceeds of enforcing security?

In general, arm's length interest payments are not subject to Luxembourg withholding tax on profit distributions, whether made to a domestic or a foreign corporate lender. An exception applies, however, to certain securities which give rise to payments that vary depending on the distribution of profit by the debtor or are made under specific profit-participating debt instruments.

6.2 What tax incentives or other incentives are provided preferentially to foreign lenders? What taxes apply to foreign lenders with respect to their loans, mortgages or other security documents, either for the purposes of effectiveness or registration?

The main tax advantage for corporate lenders, whether foreign or domestic, is the absence of withholding tax on interest payments which arise under most debt instruments.

Under certain circumstances, loans, mortgages and security documents are subject to mandatory registration formalities. Even if registration is not required by law, loans, mortgages or security documents can be subject to voluntary registration. In case of registration, registration duties will apply in the form of a fixed amount or an *ad valorem* amount depending on the nature of the document (registration duties on a loan document, for instance, amount to 0.24% applied to the principal amount indicated in the document).

6.3 Will any income of a foreign lender become taxable in your jurisdiction solely because of a loan to, or guarantee and/or grant of, security from a company in your jurisdiction?

In the absence of a permanent establishment or permanent representative of the foreign lender in Luxembourg to which the loan, the guarantee or the security is attributable, the income of the foreign lender should not become taxable in Luxembourg by reason only of the said instrument being granted to a Luxembourg company.

6.4 Will there be any other significant costs which would be incurred by foreign lenders in the grant of such loan/guarantee/security, such as notarial fees, etc.?

No stamp or registration duties are payable, and no notarisation or other similar formalities are required in general for the granting of a loan or guarantee. For security interests, please refer to question 3.9.

6.5 Are there any adverse consequences for a company that is a borrower (such as under thin capitalisation principles) if some or all of the lenders are organised under the laws of a jurisdiction other than your own? Please disregard withholding tax concerns for purposes of this question.

There are no such adverse consequences.

7 Judicial Enforcement

7.1 Will the courts in your jurisdiction recognise a governing law in a contract that is the law of another jurisdiction (a "foreign governing law")? Will courts in your jurisdiction enforce a contract that has a foreign governing law?

The choice of foreign law as the law governing the contractual rights and obligations contained in a contract is, in principle, valid and binding under Luxembourg law, in accordance with, and subject to the limitations set forth in Regulation (EC) No 593/2008 of 17 June 2008 on the law applicable to contractual obligations.

Luxembourg courts would, however, not apply a chosen foreign governing law if:

- the choice was not made *bona fide*;
- such chosen law was not pleaded and proven;
- such chosen law was pleaded and proven but held contrary to mandatory Luxembourg laws or manifestly incompatible with the public policy rules (*ordre public*) of the forum;
- at the time that the contract was entered into, all other elements relevant to the situation were located in a country other than the country of the chosen governing law, to the extent the parties' choice of governing law affects the application of the provisions of the law of that other country which cannot be derogated from by agreement, and which the court may then apply; or
- the overriding mandatory provisions of the law of the country where the obligations arising out of the contract have to be, or have been performed, render the performance of the obligations under the contract unlawful and, regarding the means of enforcement and measures to be taken by a creditor in case of a default in performance, Luxembourg courts may apply the law of the country in which performance is taking place.

A Luxembourg court may also refuse to apply the chosen governing law if a person is subject to any insolvency proceedings, in which case it would apply the insolvency laws of the jurisdiction in which such insolvency proceedings have been opened to the effects of such insolvency proceedings, without prejudice to the exceptions set forth by Regulation (EU) No 2015/848 of 20 May 2015 on insolvency proceedings (recast).

7.2 Will the courts in your jurisdiction recognise and enforce a judgment given against a company in New York courts or English courts (a "foreign judgment") without re-examination of the merits of the case?

- **English judgments**

A judgment rendered by an English competent court will be recognised and enforced in Luxembourg subject to the provisions of Regulation (EU) No 1215/2012 of 12 December 2012 on Jurisdiction and Recognition and Enforcement of Judgments in Civil and Commercial Matters (**Brussels Ia Regulation**) or Regulation (EC) No 805/2004 of 21 April 2004 creating a European Enforcement Order for uncontested claims, both as amended from time to time. In case of a hard Brexit, a UK judgment would most likely be treated like a NY judgment (see below), except for judgments falling within the scope of the Hague Convention of 30 June 2005 on choice of court agreements (the **Hague Convention**), which will come into force in the UK on 1 April 2019, absent a UK/EU Withdrawal Agreement.

According to the Brussels Ia Regulation, under no circumstances may a foreign judgement be reviewed as to its substance.

- **New York judgments**

A final and conclusive civil or commercial judgment obtained against the company in the competent courts of New York would be recognised and enforced by Luxembourg courts, subject to the applicable enforcement procedure (*exequatur*), detailed in the Luxembourg New Civil Procedure Code (the **NCPC**) and Luxembourg case law.

In accordance with Luxembourg case law, the re-examination of the merits of the case in the *exequatur* proceedings is normally excluded.

7.3 Assuming a company is in payment default under a loan agreement or a guarantee agreement and has no legal defence to payment, approximately how long would it take for a foreign lender to (a) assuming the answer to question 7.1 is yes, file a suit against the company in a court in your jurisdiction, obtain a judgment, and enforce the judgment against the assets of the company, and (b) assuming the answer to question 7.2 is yes, enforce a foreign judgment in a court in your jurisdiction against the assets of the company?

a) If the suit is filed pursuant to a commercial procedure, a decision can be obtained within six to 18 months. If the suit is filed pursuant to a civil procedure, such suit may take between six months and three years.

b) English court decisions issued in proceedings instituted on or after 10 January 2015 can be directly transmitted to a Luxembourg bailiff for enforcement. This procedure usually takes up to six months.

New York court decisions are subject to the *exequatur* procedure which requires an *exequatur* judgment to be obtained first from a Luxembourg court. This can be obtained within a year. In case of a hard Brexit, English court decisions would also be subject to the same *exequatur* procedure, except for judgments falling within the scope of the Hague Convention.

7.4 With respect to enforcing collateral security, are there any significant restrictions which may impact the timing and value of enforcement, such as (a) a requirement for a public auction, or (b) regulatory consents?

Except for regulated entities, no regulatory consents are in principle required to enforce a Luxembourg collateral security interest. There is no requirement for public auctions.

Security interests subject to the Collateral Law may be enforced upon an event of default (freely determined by the parties) and without prior notice. The security taker may benefit from various enforcement methods (appropriation, private or public sale, netting) which do not require any court involvement. The Collateral Law does not provide for any specific timing for the enforcement of the security. Timing will depend in particular on (i) the enforcement method chosen, (ii) any possible recourse of the security provider, or (iii) the potential involvement of third parties.

A sole first ranking mortgagee may enforce the mortgage by way of a fast track procedure based on the notarial deed, which constitutes an enforceable title (*titre exécutoire*). The notarial deed must provide that the mortgagee is authorised to sell the real property through a notary public without having to follow the statutory attachment procedure (*clause de voie parée*). If such a provision is not provided in the mortgage deed or if the mortgagee is not a first ranking beneficiary, it will have to organise a real estate attachment procedure involving court hearings, in order to realise the mortgage by way of a public auction.

For the enforcement of a pledge over an ongoing business concern, the pledgee must (i) serve a formal notice to pay (*mise en demeure*) to the pledgor, and (ii) attach (without any prior court authorisation) the assets subject to the pledge. The pledgee must then ask the president of the commercial court for an authorisation to sell all, or part, of the business through a public official (*officier public*) appointed by the court. The latter will then authorise the sale.

7.5 Do restrictions apply to foreign lenders in the event of (a) filing suit against a company in your jurisdiction, or (b) foreclosure on collateral security?

Foreign claimants may be obliged to elect domicile in Luxembourg, usually at an attorney's office. A Luxembourg court may order a foreign claimant to deposit a financial guarantee which is intended to cover the costs and damages to which it could be condemned.

No particular restrictions apply in case of foreclosure on collateral security.

7.6 Do the bankruptcy, reorganisation or similar laws in your jurisdiction provide for any kind of moratorium on enforcement of lender claims? If so, does the moratorium apply to the enforcement of collateral security?

In case of bankruptcy (*faillite*), controlled management (*gestion contrôlée*) and suspension of payments (*sursis de paiement*), as well as composition with creditors (*concordat préventif de faillite*), individual legal actions by privileged and unsecured creditors against the debtor are in principle suspended.

However, during a suspension of payments procedure, enforcement procedures initiated beforehand are not affected. In addition, the suspension of action does not apply to tax or other public charges, as well as certain privileged claims or certain secured creditors (in particular mortgagees or security takers under the Collateral Law).

Similarly, a composition with creditors (*concordat préventif de faillite*) has no effect on creditors who did not participate in the composition proceedings. Those creditors can continue to act against the debtor to obtain payment of their claims and can enforce their rights, obtain attachments and obtain the sale of the assets securing their claims.

These proceedings have no effect on security interests subject to the Collateral Law.

7.7 Will the courts in your jurisdiction recognise and enforce an arbitral award given against the company without re-examination of the merits?

At the request of the party who has obtained a favourable, enforceable, final and conclusive award, Luxembourg courts will enforce it, in accordance with articles 1250 and 1251 of the Luxembourg NCPC by way of *exequatur* proceedings. There will be no formal retrial or re-examination of the matters adjudicated.

8 Bankruptcy Proceedings

8.1 How does a bankruptcy proceeding in respect of a company affect the ability of a lender to enforce its rights as a secured party over the collateral security?

Bankruptcy proceedings may entail a stay of enforcement rights (see question 7.6) as well as the application of the hardening period rules (see question 8.2).

However, Luxembourg law security interests falling within the scope of the Collateral Law, as well as all enforcement measures and valuation and enforcement measures agreed upon by the parties in accordance with the Collateral Law, are valid and enforceable even if entered into during the hardening period against third parties, commissioners, receivers, liquidators and other similar persons notwithstanding the insolvency proceedings (save in the case of fraud).

Secured creditors holding a pledge over an ongoing business concern may enforce their security regardless of the opening of bankruptcy proceedings against the security provider. The proceeds from the enforcement will be applied in priority to the debt due to the security taker (subject to mandatory privileges arising by law).

Mortgages are considered outside the bankruptcy estate (*hors masse*) and may freely be enforced in spite of the adjudication in bankruptcy of the mortgagor. The proceeds from the enforcement will be applied between the secured creditors (including the mortgagee), with priority over unsecured creditors, subject to any mandatory privileges arising by law.

8.2 Are there any preference periods, clawback rights or other preferential creditors' rights (e.g., tax debts, employees' claims) with respect to the security?

Some creditors benefit from privileged rights by virtue of law and may take precedence over the rights of other secured or unsecured creditors (e.g. tax authorities, social security institutions or salaried employees).

Certain payments made, as well as other transactions (detailed in the CC) executed or performed by a bankrupt company (*faillite*) must (automatic claw-back events), or may (discretionary clawback events), be declared cancelled if made or performed during the hardening period, which is no more than six months (plus 10 days in certain circumstances) as from the date on which the Luxembourg court formally declares the company bankrupt.

In addition, the bankruptcy receiver can challenge any fraudulent payments and transactions made before the bankruptcy, without any time limit.

8.3 Are there any entities that are excluded from bankruptcy proceedings and, if so, what is the applicable legislation?

Certain regulated entities are subject to specific insolvency legislation. In particular:

- Luxembourg credit institutions and certain professionals of the financial sector are subject to the provisions of the law of 5 April 1993 on the financial sector, as amended (the **1993 Law**), in relation to recovery planning, intra-group financial support and early intervention; and
- Luxembourg insurance companies are subject to specific on reorganisation measures and winding-up procedures under the law of 7 December 2015 on the insurance sector.

8.4 Are there any processes other than court proceedings that are available to a creditor to seize the assets of a company in an enforcement?

Yes; see question 7.4.

9 Jurisdiction and Waiver of Immunity

9.1 Is a party's submission to a foreign jurisdiction legally binding and enforceable under the laws of your jurisdiction?

Except for actions brought for non-contractual claims, a Luxembourg company's submission to a foreign jurisdiction would, in principle, be upheld by Luxembourg courts.

Such submission may, however, be limited or denied (i) by, *inter alia*, the rules on exclusive jurisdiction set out by the Brussels Ia Regulation or in the case of a submission to a non-EU Member State court, or if there is no close connection with the instance in question and a hearing in such a country may appear impossible or unreasonable, or (ii) if proceedings have been commenced abroad between the same parties and on the same grounds as the proceedings in Luxembourg.

Notwithstanding the foreign jurisdiction clause, Luxembourg courts may also have jurisdiction under certain circumstances.

Foreign judgments in civil and commercial matters are generally recognised and enforced in Luxembourg, subject to the relevant *exequatur* procedure, which may be facilitated by EU regulations, or applicable international treaties.

9.2 Is a party's waiver of sovereign immunity legally binding and enforceable under the laws of your jurisdiction?

A Luxembourg company is not entitled to claim immunity in Luxembourg from suit, attachment, execution or other legal processes with respect to any action or proceeding brought in connection with its commercial contractual obligations. Other entities that are vested with sovereign immunity in Luxembourg, such as, for example, foreign states, can under certain circumstances waive such immunity. To be legally binding and enforceable in Luxembourg, the waiver shall be certain, specific and formally valid.

10 Licensing

10.1 What are the licensing and other eligibility requirements in your jurisdiction for lenders to a company in your jurisdiction, if any? Are these licensing and eligibility requirements different for a "foreign" lender (i.e. a lender that is not located in your jurisdiction)? In connection with any such requirements, is a distinction made under the laws of your jurisdiction between a lender that is a bank *versus* a lender that is a non-bank? If there are such requirements in your jurisdiction, what are the consequences for a lender that has not satisfied such requirements but has nonetheless made a loan to a company in your jurisdiction? What are the licensing and other eligibility requirements in your jurisdiction for an agent under a syndicated facility for lenders to a company in your jurisdiction?

Lending to "non-group" companies is subject to licence requirements, subject to certain limited exceptions.

Carrying on lending operations *vis-à-vis* the public without holding the appropriate licence may trigger administrative and criminal penalties.

There are no restrictions on granting security over movable or immovable property to foreign lenders. However, pledges over an ongoing business concern may only be granted to certain authorised credit institutions and breweries.

A security trustee/agent located outside Luxembourg is not required to meet any specific regulatory requirements to act as a trustee agent.

11 Other Matters

11.1 Are there any other material considerations which should be taken into account by lenders when participating in financings in your jurisdiction?

■ **Compounding of interest**

Under Luxembourg law, interest may not accrue on interest that is due on capital, unless such interest has been due for at least one year and subject to the conditions set forth in article 1154 of the Luxembourg Civil Code. The provisions of article 1154 are generally considered to be a part of Luxembourg internal public policy rules (*ordre public interne*). In the absence of case law, there are uncertainties as to whether such restriction will be upheld by Luxembourg court as being part of public international law and thus, if there is any provision to the contrary, it would be null and void.

■ **GDPR consideration**

When processing personal data, lenders must comply with Regulation (EU) 2016/679 of the European Parliament and of the Council of 27 April 2016 on the protection of natural persons with regard to the processing of personal data and on the free movement of such data (the **GDPR**) and the Luxembourg law of 1 August 2018 on the organisation of the National Commission for Data Protection and implementing the GDPR.

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Chapter 62

Mexico


José Ignacio Rivero Andere


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1 Overview

1.1 What are the main trends/significant developments in the lending markets in your jurisdiction?

The outlook for the lending markets in Mexico is yet to be fully assessed and must be analysed jointly with multiple factors, including the current political landscape.

On the positive side, the newly agreed USMCA (United States–Mexico–Canada Agreement) has halted the uncertainty that the cancellation of NAFTA would have caused and is expected to bring new business opportunities and to enhance business activity in Mexico.

Also, Mexico's significant underbanked middle class – one of the largest in Latin America – is an attractive target for the development of lending markets in our country.

Likewise, there is still confidence that the structural reforms passed by Mexico's former administration will continue to set the foundation for new deal opportunities in our lending market.

Other positive but less relevant developments are: (a) the enactment of the highly praised Law for the Regulation of Financial Technology Institutions (the "Fintech Law"), which seeks to regulate crowdfunding, electronic payment funds, and cryptocurrencies; and (b) the potential liberalisation of the trade of cannabis, which is expected to create opportunities in the creation and development of this market.

Notwithstanding the foregoing and on the negative side, there is growing uncertainty and negative economic forecasts in Mexico, mainly as a result of new policies and initiatives undertaken by Mexico's new president Andres Manuel Lopez Obrador. These include, among others:

- The unilateral cancellation of infrastructure projects such as the new Mexico City Airport.
- The interruption of pending rounds for oil blocks in the Gulf of Mexico and the uncertainty regarding PEMEX's future.
- The significant reduction in the government payroll, the relocation of multiple government agencies, and the potential departure from government of its human talent as a result of the above.
- The potential implementation of policies against the autonomy of the central bank and other Mexican constitutional autonomous bodies that constitute essential checks and balances for the executive branch.
- A general pattern of populism in government decisions that has resulted in poor economic results so far.

1.2 What are some significant lending transactions that have taken place in your jurisdiction in recent years?

Below are some significant lending transactions that have taken place in our jurisdiction in recent years and in which we (Gonzalez Calvillo) have acted as counsel:

Macquarie Capital and Techint, as sponsors, in the highly complex US$1.2 billion acquisition, development and project financing of the landmark 907MW Norte III power plant in Mexico, which will generate power for the Federal Electricity Commission pursuant to a 25-year PPA. *This transaction was bestowed with the "LATAM Power Deal of the Year" award by Project Finance International (Thompson Reuters); the "Latin American Power & Overall Deal of the Year" award by IJ Global (Euromoney); the "Project Finance Deal of the Year" award by Latin Lawyer; and the "Best Power Financing Deal" award by Latin Finance in the Project & Infrastructure Finance Awards 2018.*

Mexican Development Banks BANORTE, BANCOMEXT and NAFIN, as lenders, in the Pesos $17,750 million senior loan financing granted in favour of Altan Redes for the development of the Red Compartida Project. *This transaction was bestowed with the "Best Loan (LATAM)" and "Best Infrastructure Financing: Mexico" award by Latin Finance for the 2017 Project & Infrastructure Finance Awards; the "Latin America Telecoms Deal of the Year" award by IJ Global (Euromoney); and shortlisted for "Project Finance Deal of the Year" by IFLR for the 2018 Americas Awards.*

The consortium of Huawei and Nokia, as lenders, in the US$850 million finance to Altan Redes through EPC agreements, infrastructure and service financing for the development of the Red Compartida Project. *This transaction was bestowed with the "Best Loan (LATAM)" and "Best Infrastructure Financing: Mexico" award by Latin Finance for the 2017 Project & Infrastructure Finance Awards; the "Latin America Telecoms Deal of the Year" award by IJ Global (Euromoney), and shortlisted for the "Project Finance Deal of the Year" award by IFLR for the 2018 Americas Awards.*

Citigroup, Sumitomo Mitsui Banking Corporation, BNP Paribas, JPMorgan Chase, and The Bank of Nova Scotia, acting as Joint Lead Arrangers and Joint Bookrunners, in a simultaneous syndicated credit facility and a Rule 144A / Reg. S bond offering to allow private equity fund Actis to successfully complete its acquisition of global power-generation company InterGen's business interests in Mexico, including the purchase of 2,200 MWs in operation with six combined-cycle power generation projects, a 155 MW wind project with partner IEnova, a 65-kilometre natural-gas pipeline, and three natural gas-compression stations, for an enterprise value of US$1.256 billion. This is the first time that a project acquisition in Mexico of this size has been executed with the use of bond proceeds. *This transaction was bestowed with the "Best Infrastructure Financing in Mexico" award by Latin Finance in the Project & Infrastructure Finance Awards 2018; and the "Mexico Structured Bond Deal of the Year" award by GFC Media Group in the Bonds & Loans Awards 2019.*

2 Guarantees

2.1 Can a company guarantee borrowings of one or more other members of its corporate group (see below for questions relating to fraudulent transfer/financial assistance)?

Yes, it can. Pursuant to both Mexican and foreign law, and provided that in the case of the latter, certain provisions regarding, among others, representations of the Mexican guarantor, choice of law/forum, waiver of certain specific remedies set forth in Mexican law and due service of process, must be included in the documentation to ensure enforceability of a judgment under a foreign guarantee in Mexico.

2.2 Are there enforceability or other concerns (such as director liability) if only a disproportionately small (or no) benefit to the guaranteeing/securing company can be shown?

Enforceability of guarantees and/or collateral in Mexico may be limited by bankruptcy (*concurso mercantil*), insolvency, dissolution and liquidation, reorganisation, moratorium, labour, and tax, among other laws of general application affecting the rights of creditors and obligations of debtors.

As per director liability, there is no specific concern regarding the benefit to the guaranteeing company. However, directors of a securing company, when assessing and approving a specific transaction, must comply with their statutory duties.

Such duties in private companies entail that a director must refrain from voting in any meetings on matters in which they have or may have a conflict of interest.

In the case of public companies, directors must meet the duties of loyalty and care. The duty of care consists of directors acting in good faith and in the best interest of the company, while the duty of loyalty consists of (i) maintaining the confidentiality of information received in connection with the performance of a director's duties while such information is not made publicly available, and (ii) abstaining from discussing or voting on matters where a director has a conflict of interest.

2.3 Is lack of corporate power an issue?

Yes. The validity of guarantees/collateral granted by a Mexican securing company both under Mexican law or foreign law is subject to: (a) the bylaws/articles of incorporation of the securing company providing as part of its corporate purpose the authority to act as guarantor or grantor of third-party obligations; (b) certain corporate approvals being complied with; and (c) the securing company executing (directly or through a joinder agreement) the relevant guarantee/collateral documentation through a duly appointed legal representative with sufficient powers and authorities pursuant to Mexican law. Additional requisites may apply for regulated Mexican securing companies.

2.4 Are any governmental or other consents or filings, or other formalities (such as shareholder approval), required?

Corporate authorisations, including BOD and/or shareholder approvals, may be required under the bylaws of the securing company.

Third-party consents may be required depending on the contractual obligations assumed by the securing company.

Except for regulated securing companies, governmental authorisations are not generally required. Notwithstanding the foregoing, depending on the type of collateral being granted, certain formalities and filings may apply (please refer to question 3.2 below).

2.5 Are net worth, solvency or similar limitations imposed on the amount of a guarantee?

No. However, limitations on the enforceability of a guarantee must be taken into consideration.

2.6 Are there any exchange control or similar obstacles to enforcement of a guarantee?

No exchange controls apply.

If enforcement of a foreign judgment is sought before a Mexican court, certain requirements (set forth in article 1347-A of the Mexican Commerce Code) would need to be met. These requirements are: (a) the foreign judgment having to comply with the formalities set forth in the international treaties to which Mexico and the country issuing the judgment is a party; (b) the foreign judgment being issued based on an *in rem* action (as opposed to an *in personam* action); (c) the judge or court rendering the foreign judgment being competent to hear and judge on the subject matter of the case in accordance with accepted rules of international law that are compatible with Mexican law; (d) service of process related to the foreign judgment being carried out personally on the parties or on their duly appointed process agents; (e) the foreign judgment being final in the jurisdiction where it was obtained; (f) the action in respect of which the foreign judgment was rendered not being the subject matter of a lawsuit among the same parties which is pending before a Mexican court; (g) the foreign judgment not contravening Mexican law or public policy (*órden público*); and (h) the foreign judgment complying with all necessary requirements to be considered as authentic.

In addition to the foregoing, other Mexican law limitations may come into play in any enforcement procedure, including, among others: (a) the possibility for debtors to discharge their obligations in Mexican Pesos, notwithstanding such obligations being in a foreign currency; (b) the inability of lenders to collect interest-on-interest; (c) the impossibility to waive procedural rights protected under public policy; (d) the impossibility of enforcing claims outside the applicable statutes of limitations; and (e) the need of judicial intervention for the taking of possession, entry or removal of property, or similar actions.

3 Collateral Security

3.1 What types of collateral are available to secure lending obligations?

As a general rule and except for public domain assets or analogues, collateral can be created over any type of asset, with the most common being pledges (over equity interests or movable assets), security trusts, and mortgages (over real estate).

3.2 Is it possible to give asset security by means of a general security agreement or is an agreement required in relation to each type of asset? Briefly, what is the procedure?

Except in the case of the collateral form described in point 3 of this question, the use of general security agreements is not a common practice in Mexico, mainly to prevent contamination between the different types of collateral, the formalities for their implementation, their remedies, and the enforcement thereof. The usual way for creating collateral in Mexico is through the following:

1. Pledge over equity interests/shares. Equity interests that represent the capital stock of limited liability companies can be granted as collateral to guarantee payment obligations. To fulfil the requirements set forth in the applicable law, the following actions must be carried out.

A pledge agreement must be executed between the lender/security agent as pledgee and the borrower/securing company (holder of the issuing entity's capital quotas) as pledgor, with the appearance of the issuing entity.

The pledge must be registered in the corporate book of the issuing entity.

In case it is deemed convenient for the pledge to have priority over tax credits, the pledge agreement must be ratified before a Mexican notary public and registered before the *Registro Único de Garantías Mobiliarias*.

In the case of corporations, the foregoing must be complied with, on the understanding that the stock certificates of the issuing company must be delivered and endorsed (*endosados*) in favour of the pledgee.

Finally, a recommended practice is for a power-of-attorney to be granted to the pledgee to exercise the voting powers of the pledged equity interests/shares in the event of a default.

2. Pledge over movable assets. There are two ways to create pledges over movable assets: (a) a regular pledge (possession of the pledged assets is transferred to the pledgee); or (b) a floating/non-possessory pledge (possession of the pledged assets remains with the pledgor); the latter being more common in the implementation of Mexican collateral as it is less intrusive with the operations of the pledgor.

In both cases, a pledge agreement must be executed and thereafter ratified before a Mexican notary public. Finally, the agreement must be registered before the *Registro Único de Garantías Mobiliarias* ("RUG"), in order for the collateral to be publicly registered and thus enforceable *vis-à-vis* third-parties. Please consider that other consents or registrations may be required depending on the specific collateral and/or grantor (e.g. in the case of pledges over IP, the pledge will need to be registered before the Mexican Institute of Industrial Property).

3. Security trust. This is one of the most flexible structures as it allows for a single securing assembly to be implemented pursuant to which different kinds of assets may be granted as collateral. Likewise, it may encompass all (or most) of the assets of the grantor.

Under this structure, the grantor transfers title of the collateralised assets to a trust (to be managed by a Mexican financial institution as trustee) for the benefit of the secured party. In other words, it has the purpose of securing the relevant payment obligations with the trust assets and of providing a servicing mechanism for the corresponding debt.

The formalities to implement a security trust depend on the assets being contributed thereto as collateral; however, these generally include (i) the implementation of a trust agreement, (ii) the granting/ratification of the agreement before a Mexican notary public, and (iii) filing of the trust with the applicable Mexican authorities/registries, provided that the nature of the filing depends on the type of assets being transferred to the trust (generally speaking, the trust has to be filed with the RUG; however, filing with other registries may apply (e.g. real estate assets – public registry of property, IP – Mexican Institute of Industrial Property, etc.)).

The main benefits of a security trust (*versus* a combination of pledges and mortgages) are: (i) the collateralised assets will be bankruptcy remote, thus protecting the secured party in the event of the grantor's bankruptcy or insolvency; (ii) the secured parties can exert a higher degree of control over the trust assets; and (iii) a non-judicial enforcement procedure may be agreed by the parties to the trust, thus allowing for a more efficient and structured enforcement of the collateral to take place.

That being said, the implementation of a trust agreement will imply a more expensive structure (given the applicable trustee, notarial and registration fees) and may in some ways interfere with the day-to-day operations of the borrower/guarantor.

This collateral structure is very common in project finance and is convenient to isolate the collateralised/project assets from the sponsor, and to have a greater control over these assets in an event of default.

4. Mortgage. Mortgages are used to create collateral over real estate (e.g. land, buildings, etc.). Mortgages must be executed in a public instrument before a Mexican notary public. For a mortgage to be effective *vis-à-vis* third-parties, it must be duly registered in the public registry of property corresponding to the collateralised asset's location. Registration fees may vary depending on the secured amount and the Mexican state in which the corresponding asset is located.

Please note that other forms of security are applicable to regulated assets (e.g. airplanes and vessels).

3.3 Can collateral security be taken over real property (land), plant, machinery and equipment? Briefly, what is the procedure?

Yes, collateral over real property can be created by means of a mortgage or a security trust governed under Mexican law (please refer to question 3.2, items 3 and 4, above). Regarding the creation of a security interest over machinery and equipment, this can be done through a pledge or a security trust (please refer to question 3.2, items 2 and 3, above).

3.4 Can collateral security be taken over receivables? Briefly, what is the procedure? Are debtors required to be notified of the security?

Yes, through a pledge or a security trust (please refer to question 3.2, items 2 and 3, above).

It is important to note that debtors are not required to be notified for the perfection of collateral over receivables to be valid; however, it is convenient to do so, so that they can acknowledge (i) the existence of the collateral, and (ii) that, in an event of foreclosure, they must pay any amounts under the receivables to the lenders. Otherwise, debtors would be released from their obligations by paying to the pledgor.

3.5 Can collateral security be taken over cash deposited in bank accounts? Briefly, what is the procedure?

Yes, by means of a pledge (please refer to question 3.2, item 2, above).

3.6 Can collateral security be taken over shares in companies incorporated in your jurisdiction? Are the shares in certificated form? Can such security validly be granted under a New York or English law-governed document? Briefly, what is the procedure?

Security can be taken over shares issued by a Mexican entity through a pledge agreement or a security trust (please refer to question 3.2, items 1 and 4, above). Note that in the case of security over shares being created through a trust, the relevant shares are transferred to the trust and thus the trust becomes a shareholder of the issuing entity.

It is not possible to create collateral over shares issued by a Mexican entity through foreign documents.

3.7 Can security be taken over inventory? Briefly, what is the procedure?

Yes; through a pledge or a security trust (please refer to question 3.2, items 2 and 4, above).

3.8 Can a company grant a security interest in order to secure its obligations (i) as a borrower under a credit facility, and (ii) as a guarantor of the obligations of other borrowers and/or guarantors of obligations under a credit facility (see below for questions relating to the giving of guarantees and financial assistance)?

Yes, it can. In the understanding that, as set forth above, in order to do so, it should be permitted under its corporate purpose.

3.9 What are the notarisation, registration, stamp duty and other fees (whether related to property value or otherwise) in relation to security over different types of assets?

When granting collateral under Mexican law, the participation of a notary public is usually required. The corresponding notarial fees will depend on the type of asset being collateralised and on the total value of the secured obligation. These fees are usually capped but could represent large amounts, on the understanding that, in large transactions, notaries are usually amenable to granting fee discounts.

Registration fees are generally required for security granted over real estate, can be material, and are associated with the registration of the collateral before the public registries of property of the place where the assets are located. In most cases, these registration fees are capped by local authorities, and, in cases where the transaction is associated with benefits for the population or state, special discounts may apply.

Also, registration fees are generally required for security over movable assets, are not material, and are associated with the registration of the collateral before the RUG.

Please note that, in addition to the above, in some other cases and with respect to certain local jurisdictions, additional taxes or fees may be required to be paid for the perfection and/or registration of a security. Moreover, other forms of registration could be applicable to regulated assets (e.g. airplanes and vessels).

3.10 Do the filing, notification or registration requirements in relation to security over different types of assets involve a significant amount of time or expense?

The timing and expenses involved in the filing and registration of Mexican collateral can significantly vary on a case-by-case basis but, generally speaking and except in the case of real state collateral, they should not be significant.

3.11 Are any regulatory or similar consents required with respect to the creation of security?

It depends if the collateral or overall financing involves regulated entities/assets. For example, security over permits, concessions, procurement contracts, licences and other regulated assets (such as pipelines, water treatment plants, energy plants, mining properties, highways, airports, and generally public infrastructure), or over companies or entities that use, procure, manage and/or operate such assets, will typically require prior governmental approval to create a security interest over them (or, at best, prior notice to the relevant authorities). If no regulated entities/assets are involved, then no regulatory consents are required.

3.12 If the borrowings to be secured are under a revolving credit facility, are there any special priority or other concerns?

No special priority or concerns apply.

3.13 Are there particular documentary or execution requirements (notarisation, execution under power of attorney, counterparts, deeds)?

Please refer to questions 3.2, 3.9 and 3.10 above.

4 Financial Assistance

4.1 Are there prohibitions or restrictions on the ability of a company to guarantee and/or give security to support borrowings incurred to finance or refinance the direct or indirect acquisition of: (a) shares of the company; (b) shares of any company which directly or indirectly owns shares in the company; or (c) shares in a sister subsidiary?

Generally, no prohibitions or restrictions apply.

5 Syndicated Lending/Agency/Trustee/ Transfers

5.1 Will your jurisdiction recognise the role of an agent or trustee and allow the agent or trustee (rather than each lender acting separately) to enforce the loan documentation and collateral security and to apply the proceeds from the collateral to the claims of all the lenders?

Yes; it is customary in cross-border transactions involving Mexico. Depending on the transaction structure, the granting by the corresponding secured parties of a power-of-attorney to the agent is advisable.

5.2 If an agent or trustee is not recognised in your jurisdiction, is an alternative mechanism available to achieve the effect referred to above which would allow one party to enforce claims on behalf of all the lenders so that individual lenders do not need to enforce their security separately?

This is not applicable in Mexico.

5.3 Assume a loan is made to a company organised under the laws of your jurisdiction and guaranteed by a guarantor organised under the laws of your jurisdiction. If such loan is transferred by Lender A to Lender B, are there any special requirements necessary to make the loan and guarantee enforceable by Lender B?

For the transfer to be effective, contractual requirements and obligations must be met. Also, unless Mexican entities are notified of such assignment, they would be released of their payment obligations by paying any amounts under the loan to Lender A.

6 Withholding, Stamp and Other Taxes; Notarial and Other Costs

6.1 Are there any requirements to deduct or withhold tax from (a) interest payable on loans made to domestic or foreign lenders, or (b) the proceeds of a claim under a guarantee or the proceeds of enforcing security?

Withholding taxes apply as a general rule to interest payable by borrowers to foreign lenders and Mexican entities that are not banks or financial entities. The foregoing is also applicable to the proceeds of a claim or to the proceeds of an enforcement of security which are destined for payment of amounts other than principal (i.e. interests, commissions or fees). The withholding rate will strictly depend on the type and nationality of the lender, the nature of the transaction itself and the applicability of international treaties regarding double taxation, among others.

Withholding taxes do not apply to Mexican banks and financial entities. Such entities will calculate and pay their taxes in accordance with applicable Mexican tax laws.

6.2 What tax incentives or other incentives are provided preferentially to foreign lenders? What taxes apply to foreign lenders with respect to their loans, mortgages or other security documents, either for the purposes of effectiveness or registration?

Any tax incentives, privileges, restrictions, fees, or, exemptions thereof are provided for under specific international treaties entered into by Mexico to avoid double taxation and will depend on their applicability to a specific foreign lender.

6.3 Will any income of a foreign lender become taxable in your jurisdiction solely because of a loan to, or guarantee and/or grant of, security from a company in your jurisdiction?

Foreign lenders are required to pay income tax if they have a permanent establishment within the Mexican territory, or when the income comes from sources within the Mexican territory.

6.4 Will there be any other significant costs which would be incurred by foreign lenders in the grant of such loan/guarantee/security, such as notarial fees, etc.?

As explained before, there are several costs and fees that will apply when structuring, implementing and perfecting collateral in Mexico. For a more detailed explanation, please refer to section 3 above.

6.5 Are there any adverse consequences for a company that is a borrower (such as under thin capitalisation principles) if some or all of the lenders are organised under the laws of a jurisdiction other than your own? Please disregard withholding tax concerns for purposes of this question.

No, there are not.

7 Judicial Enforcement

7.1 Will the courts in your jurisdiction recognise a governing law in a contract that is the law of another jurisdiction (a "foreign governing law")? Will courts in your jurisdiction enforce a contract that has a foreign governing law?

Yes. Mexican law allows for the parties to contractually agree to governing law and forum in Mexico or abroad, provided that, for this submission to be valid, it must comply with the applicable requirements under Mexican law.

Mexican judicial authorities would enforce a foreign judgment so long as the requirements for such enforcement are met (please refer to question 2.6 above).

7.2 Will the courts in your jurisdiction recognise and enforce a judgment given against a company in New York courts or English courts (a "foreign judgment") without re-examination of the merits of the case?

Yes, subject to: (i) the submission to the foreign court being valid (please refer to question 7.1 above); and (ii) the foreign judgment complying with the specific Mexican law-related requirements (please refer to question 2.6 above).

7.3 Assuming a company is in payment default under a loan agreement or a guarantee agreement and has no legal defence to payment, approximately how long would it take for a foreign lender to (a) assuming the answer to question 7.1 is yes, file a suit against the company in a court in your jurisdiction, obtain a judgment, and enforce the judgment against the assets of the company, and (b) assuming the answer to question 7.2 is yes, enforce a foreign judgment in a court in your jurisdiction against the assets of the company?

Timing depends on the circumstances of the particular cases, applicable foreign governing laws, and applicable foreign jurisdictions, as well as on its consistency with Mexican law principles.

7.4 With respect to enforcing collateral security, are there any significant restrictions which may impact the timing and value of enforcement, such as (a) a requirement for a public auction, or (b) regulatory consents?

Yes, there are.

Foreclosure on a mortgage or "regular" pledge (i.e. where possession is effectively transferred to the creditor as depository) will typically require a summary judicial procedure that would ultimately result in public auctions to sell (or transfer) the collateral as payment to the lenders. For non-possessory pledges and security trusts, it is possible to choose between a judicial and a non-judicial procedure.

Regarding regulatory consents, generally, the same consents required for the creation of security will apply to its foreclosure.

In addition, enforcement can be significantly affected or impacted in case of reorganisations or bankruptcy under applicable law.

Finally, foreign lenders may be restricted from owning certain assets (including stock) as re result of limitations on foreign investment, or in the case of regulated assets. That said, lenders may foreclose on Mexican collateral looking to sell off the underlying asset to a third party without ever becoming the legal owner thereof.

7.5 Do restrictions apply to foreign lenders in the event of (a) filing suit against a company in your jurisdiction, or (b) foreclosure on collateral security?

Not generally. However, as set forth in question 7.4 above, certain restrictions will apply to foreign lenders looking to foreclose on restricted assets.

7.6 Do the bankruptcy, reorganisation or similar laws in your jurisdiction provide for any kind of moratorium on enforcement of lender claims? If so, does the moratorium apply to the enforcement of collateral security?

Yes. Under Mexico's Federal Bankruptcy Law (*Ley de Concursos Mercantiles*), as of the date of the bankruptcy judgment and until the end of the reorganisation stage, no claim or foreclosure will be enforceable against a company.

7.7 Will the courts in your jurisdiction recognise and enforce an arbitral award given against the company without re-examination of the merits?

Yes. Under Mexican law, courts have a legal binding obligation to recognise arbitration clauses and the contractual submission of potential controversies to arbitration. The foregoing will be subject to compliance with procedural and formal requirements under the Mexican Constitution, the Mexican Commerce and Civil Codes and applicable international treaties.

In connection with the foregoing, please note that enforcement of an arbitral award may not be granted if, among others: (a) one of the parties to the arbitration agreement did not have adequate or sufficient legal capacity to enter into such arrangement or such arrangement is not valid under the laws chosen by the parties; (b) service of process is not correctly and legally carried out; (c) the award refers to a controversy which, under the terms of the arbitration agreement, was not subject to arbitration or contains a decision that exceeds the terms of such arbitration agreement; (d) the subject matter of the arbitration procedure cannot be arbitrated or the enforcement of the award is contrary to Mexican law or public policy, international treaties or agreements binding upon Mexico; or (e) the award is not final in the jurisdiction where it was obtained.

8 Bankruptcy Proceedings

8.1 How does a bankruptcy proceeding in respect of a company affect the ability of a lender to enforce its rights as a secured party over the collateral security?

Mexico's Federal Bankruptcy Law is the general statute governing reorganisation and bankruptcy proceedings in Mexico. Reorganisation and/or bankruptcy proceedings will directly affect enforcement of a security by a lender, but such affectation will significantly vary depending on the kind of security interest granted to such lender and its robustness.

Subject to applicable exemptions and specific rights, the aforementioned statute treats a lender secured under a security structure as a secured creditor. There are some important benefits afforded to a secured creditor, generally including priority ranking, continued ordinary interest accrual, loan currency protection and (subject to some exemptions) ability to participate or not in the eventual creditor agreement that concludes the reorganisation procedure. In the event no agreement is reached, and the relevant company becomes bankrupt, secured creditors have the right to foreclose on their security, and they have the same right if such an agreement is validly reached but not signed by the relevant creditor.

It is also important to note that, given that under a security trust structure, title to the assets that form the trust estate is transferred to the relevant trustee and, therefore, subtracted from the estate of the relevant grantor, lenders secured by or through a trust have, through this form of security, a vehicle that is remote to the bankruptcy of the grantor under applicable law. Please note, however, that in recent cases, while this remoteness has been generally accepted by Mexican courts, precautionary measures issued by Mexican courts have temporarily frozen enforcement and foreclosure of assets under trusts on the basis that, among others, the company subject to the reorganisation procedure needs to use such assets for its survival.

8.2 Are there any preference periods, clawback rights or other preferential creditors' rights (e.g., tax debts, employees' claims) with respect to the security?

Yes. The Federal Bankruptcy Law and its associated regulations generally provide for a 270-day clawback period to protect creditors from fraudulent conveyance by the company subject to the reorganisation procedure.

Likewise, such statute, subject to exemptions and interpretation, sets forth the following ranking for creditor priority: (a) singularly privileged creditors (i.e. burial and sickness expenses); (b) secured creditors (those secured with an *in rem* guarantee, such as the pledges and mortgages); (c) specially privileged creditors; and lastly (d) unsecured creditors.

Please note that credits against the asset mass, such as certain tax or labour credits, debts incurred while at the reorganisation process, asset maintenance and other similar costs, may have higher ranking than secured credits and will typically be paid first.

8.3 Are there any entities that are excluded from bankruptcy proceedings and, if so, what is the applicable legislation?

Governmental entities (i.e., the union, states, municipalities, and certain government entities) are not subject to the Federal Bankruptcy

Law. That said, governmental entities have implemented trust structures to, among multiple others, guarantee debt instrument offerings and other forms of financing.

8.4 Are there any processes other than court proceedings that are available to a creditor to seize the assets of a company in an enforcement?

Yes; nevertheless, Mexican law does not allow the actual seizing or taking possession of assets through out-of-court proceedings; thus such seizure or taking possession of must be undertaken and approved by Mexican courts.

9 Jurisdiction and Waiver of Immunity

9.1 Is a party's submission to a foreign jurisdiction legally binding and enforceable under the laws of your jurisdiction?

Yes, it is, subject to compliance with certain requirements (please refer to question 7.1 above).

9.2 Is a party's waiver of sovereign immunity legally binding and enforceable under the laws of your jurisdiction?

A waiver of immunity is traditionally valid in Mexico; thus, sovereign immunity is not recognised.

10 Licensing

10.1 What are the licensing and other eligibility requirements in your jurisdiction for lenders to a company in your jurisdiction, if any? Are these licensing and eligibility requirements different for a "foreign" lender (i.e. a lender that is not located in your jurisdiction)? In connection with any such requirements, is a distinction made under the laws of your jurisdiction between a lender that is a bank *versus* a lender that is a non-bank? If there are such requirements in your jurisdiction, what are the consequences for a lender that has not satisfied such requirements but has nonetheless made a loan to a company in your jurisdiction? What are the licensing and other eligibility requirements in your jurisdiction for an agent under a syndicated facility for lenders to a company in your jurisdiction?

There are no licensing or other eligibility requirements under Mexican law as a general rule.

11 Other Matters

11.1 Are there any other material considerations which should be taken into account by lenders when participating in financings in your jurisdiction?

No, there are not.

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Mozambique

Gonçalo dos Reis Martins

TTA – Sociedade de Advogados / PLMJ

Nuno Morgado Pereira

1 Overview

1.1 What are the main trends/significant developments in the lending markets in your jurisdiction?

Mozambique's momentum of mega gas projects is growing, but multiple challenges lie ahead.

From a micro banking perspective, we expect the effects of the Bank of Mozambique's 2017 and 2018 monetary easing cycle to continue feeding through into improved lending conditions over 2019. The Bank of Mozambique's incentive on the reduction of interbank landing rates has seen an easing of lending conditions in the banking sector, which has brought weighted average commercial bank lending rates as well.

In the private sector, while we anticipate that higher inflation will also weigh on demand for credit, reduced asset quality in the wake of the government's debt crisis will keep banks cautious in issuing loans to potential borrowers. Headwinds to this economy sector lending will, therefore, keep credit growth relatively subdued in 2019.

Additionally, ongoing lack of external budgetary support will reinforce extensive government borrowing from domestic banks, which will continue to drive overall asset growth while crowding-out lending to the private sector. The government's heavy reliance on domestic financing has seen the Mozambican banking sector's bond portfolio grow sharply in the wake of its debt crisis.

On the other hand, Mozambique's first liquefied natural gas export project is still under construction, two much larger developments are targeting final investment decisions in 2019, and the impoverished African nation of 30 million people could go from zero to the sixth-largest LNG producer in the world by the mid-2020s. The two mega-projects – one led by ExxonMobil and Eni and the other led by Anadarko – have a combined development cost of $55 billion and would bring 28 million tonnes of annual liquefaction capacity on-stream by 2025. Those two ventures, plus the smaller floating LNG project under construction and scheduled to enter service in 2022, would put Mozambique just behind 35-year LNG exporter Malaysia and world leaders Qatar, Australia, the United States and Russia. We anticipate that such projects will have a significant optimistic effect on the country's financial situation and lending market.

1.2 What are some significant lending transactions that have taken place in your jurisdiction in recent years?

The gas and coal projects in the north off the country are capital intensive and require large-scale financing from the world's leading financial institutions.

Late in 2017, the so-called Coral project relating to Area 1 of the offshore gas fields in the Cabo Delgado province in a consortium led by ENI came to a financial close with a $20 billion syndicated facility.

Also of note is the multi-billion-dollar financing of the $4 billion Nacala Corridor Rail and Port project in Mozambique and Malawi. This is the largest ever successful project financing of infrastructure development in Sub-Saharan Africa. The Project comprises the construction, refurbishment, and operation of a 912 km railway line through Mozambique and Malawi as well as the construction and operation of a coal terminal in the port of Nacala-a-Velha, Mozambique. The railway will link Vale Mozambique's Moatize coal project in Tete Province, Mozambique, with the port.

During 2018, Cahora Bassa Hydroelectric Plant (HCB) announced a 10-year investment plan totalling €500 million of vital Capex, to recover and modernise the company's electricity production system.

2 Guarantees

2.1 Can a company guarantee borrowings of one or more other members of its corporate group (see below for questions relating to fraudulent transfer/financial assistance)?

As a general rule, corporate powers are restricted to those rights and obligations which are necessary or convenient for accomplishing the purpose of the company (which, generally, is to make a profit).

In accordance with Article 88 (3) of the Mozambican Commercial Code, there is a legal presumption that the granting of guarantees in respect of obligations of other entities is contrary to the purpose of a company, unless there is a justifiable own interest of the company in providing the guarantee or the company in question is in a group relationship with such entity.

Such justifiable own interest of the company is evident in the provision of downstream guarantees, but is less evident in the provision of upstream and cross-stream guarantees. In the case of upstream and cross-stream guarantees, it is advisable for the relevant resolutions to be passed justifying the own interest of the company, which may be an indirect one, in providing the guarantee.

2.2 Are there enforceability or other concerns (such as director liability) if only a disproportionately small (or no) benefit to the guaranteeing/securing company can be shown?

In such situations, it is likely that there is no justifiable own interest to the company in providing the guarantee/security and unless the company is in a group or controlling relationship with the entity whose obligations it guarantees/secures, the provision of the guarantee/security may be considered null and void.

The provision of the guarantee or security with disproportionate small (or no) benefit to the company may give rise to the breach of duties of directors towards the company and, therefore, liability.

2.3 Is lack of corporate power an issue?

Yes, please see question 2.1 above.

2.4 Are any governmental or other consents or filings, or other formalities (such as shareholder approval), required?

Except for certain state-owned and other public-sector companies, unless there is a restriction contained in the articles of association of the company, in principle, no governmental approvals or consents are required by law for a guarantee provided by a Mozambican company to be enforceable.

It is common practice for there to be a requirement for either shareholder or board approval for the granting of a guarantee. Usually, such approval will contain an express reference to the benefit to the company from the provision of the guarantee (even if such benefit is an indirect one) or to the group relationship (if any) with the entity benefiting from the provision of the guarantee.

Additionally, the Mozambican Commercial Code sets forth that guarantees/security shall be registered in an internal record book kept by the company.

It should also be noted that the recent legal framework regarding the registry of security in movable assets with the *Central de Registo de Garantias Mobiliárias* establishes that all security agreements concerning movable assets, assigned to secure lending obligations, must be registered at the *Central de Registo de Garantias Mobiliárias* in order for publicity to be given and to make them enforceable against third parties. Such registry is valid for an initial period of five years, and may be renewed at the guarantor's request.

2.5 Are net worth, solvency or similar limitations imposed on the amount of a guarantee?

No, they are not, but please see question 2.2 above as to corporate benefit.

2.6 Are there any exchange control or similar obstacles to enforcement of a guarantee?

In general terms, the import and export of foreign exchange, as well as the provisions of security or guarantees by a Mozambican entity to a foreign lender, is subject to the prior authorisation of the Bank of Mozambique, except in limited circumstances under law (the "**Foreign Exchange Law**") and the Bank of Mozambique regulation – Aviso 20/GBM/2017 (the "**Foreign Exchange Regulation**"), together with the Foreign Exchange Law, "Foreign Exchange Rules"). Pursuant to the Aviso 7/GBM/2018 (the "**Foreign Exchange Regulation for Oil & Gas Projects**"), the contracting of external lending facilities by any oil & gas operator or concessionaire is always subject to the prior authorisation of the Bank of Mozambique.

In turn, the export of foreign exchange will only be subject to the required filing to the Bank of Mozambique, which is also made through the relevant commercial bank, if the original transaction underlying the import of foreign exchange or provision of security, has been previously duly authorised. If no prior authorisation has been obtained, then an authorisation will be required for the export of foreign exchange resulting from the enforcement of a guarantee.

Foreign lenders shall therefore ensure that the relevant authorisations are obtained from the outset to avoid having to obtain a specific authorisation whilst exporting funds deriving from the enforcement of security locally in Mozambique.

3 Collateral Security

3.1 What types of collateral are available to secure lending obligations?

There are various types of collateral available to secure lending obligations, such as:

(i) mortgage over real estate property, aircraft, vessels, cars and industrial units (e.g. factories);

(ii) pledge over movable assets not referred to in (i) above;

(iii) pledge over a business (including inventory) – only possible if pledgee is a credit institution;

(iv) pledge of rights (including credits and receivables); and

(v) escrow of income deriving from real estate, aircrafts, vessels or cars.

Moreover, surety, debt confessions, right of retention or novation or assignment of receivables and other credit rights are possible.

3.2 Is it possible to give asset security by means of a general security agreement or is an agreement required in relation to each type of asset? Briefly, what is the procedure?

Under Mozambican law, the provision of general security (i.e. over the assets of a given entity generally) is considered null and void because of lack of determination of the specific assets that become subject to the security.

Therefore, it is necessary that a security agreement identifies, to the greatest extent possible, the assets which are subject to the security created by such agreement. The security agreement must at least contain certain criteria which would allow the identification of the secured assets at a given time. Pursuant to the recent Land Registry Code, and in what particularly concerns mortgages over industrial units, an inventory of all movable assets and equipment, given as security, must be attached to the security agreement and shall be recorded together with the mortgage registration.

The agreement shall be signed by both securing and secured party, with the respective signatures certified by a public notary.

Mortgages and pledges or escrow of incomes are made through a public deed which shall be signed before a public notary, following which the public deed must be registered at the applicable registry office and with the *Central de Registo de Garantias Mobiliárias*, in accordance with the type of asset that is being encumbered.

3.3 Can collateral security be taken over real property (land), plant, machinery and equipment? Briefly, what is the procedure?

As provided by the Mozambique Constitution, the State is the sole proprietor of the land, which cannot be owned by an individual or a company. However, the State may grant them the right to use such land by issuing a title for the right of use and benefit from the land (in Portuguese, "*Direito de Uso e Aproveitamento da Terra*", DUAT"), enabling its holder to build therein any infrastructure or immovable asset and register it. Following the assets' registration, the holder of a DUAT may create security interests over such real estate, although not the land itself, by means of a mortgage. The DUAT itself cannot be assigned by way of security or pledged.

Mortgages over machinery and equipment thereof may be granted through a public deed, which must include a clear identification of the plant and other assets thereof that shall be mortgaged. As said above, with respect to mortgages over industrial units, an inventory of all assets and equipment is also required to be recorded.

3.4 Can collateral security be taken over receivables? Briefly, what is the procedure? Are debtors required to be notified of the security?

Yes, security over receivables are made through pledges which can be made over receivables. A public deed and registry with the *Central de Registo de Garantias Mobiliárias* are both required as well as the notification of the creation of pledges to the debtors, so it can be enforced again any third parties.

3.5 Can collateral security be taken over cash deposited in bank accounts? Briefly, what is the procedure?

Yes, pledges can be taken over cash deposited in bank accounts, which are deemed as pledges over credits or receivables. As with the creation of a pledge over receivables, the creation of a pledge over cash deposited in a bank account requires the execution of a public deed, registry with the *Central de Registo de Garantias Mobiliárias* and notice to the bank where the account is held.

3.6 Can collateral security be taken over shares in companies incorporated in your jurisdiction? Are the shares in certificated form? Can such security validly be granted under a New York or English law governed document? Briefly, what is the procedure?

Yes, collateral security may be taken over shares in companies incorporated in Mozambique as a pledge of shares, but the perfection requirements will vary in accordance with the nature of the company.

In the case of a public limited liability company (*sociedades anónimas*), whose share capital is represented by shares (*acções*), the perfection requirements for pledge of shares requires: the endorsement of the share certificates by the pledger (debtor); registration of the pledge in the company's register book; and registration of the pledge with the *Central de Registo de Garantias Mobiliárias* and delivery of such share certificates to the pledgee (creditor) for its perfection. If the shares are warrant-to-bearer, the delivery of the shares shall be sufficient to create the security.

Regarding private limited liability companies (*sociedades por quotas*), whose share capital is represented by quotas, the perfection requirements include the execution of the pledge agreement by means of a public deed, notification of the company on the creation of the pledge (in case prior consent is not required), and registration of the pledge with the Legal Entities Registry Office.

3.7 Can security be taken over inventory? Briefly, what is the procedure?

Yes, security over inventory is possible if such security is granted in favour of a credit institution. The procedure includes the execution of a written agreement.

3.8 Can a company grant a security interest in order to secure its obligations (i) as a borrower under a credit facility, and (ii) as a guarantor of the obligations of other borrowers and/or guarantors of obligations under a credit facility (see below for questions relating to the giving of guarantees and financial assistance)?

Yes, but please see the restrictions on the provision of guarantees in question 2.1 above, which are also applicable in relation to the provision of security interest by companies.

3.9 What are the notarisation, registration, stamp duty and other fees (whether related to property value or otherwise) in relation to security over different types of assets?

The creation of any type of securities is subject to notarial fees, registration fees and Stamp Duty, which is calculated based on the type of security and the period for which it is granted. Mortgages and pledges are subject to a 0.3% Stamp Duty, unless such transaction is deemed ancillary to another transaction (loan) already subject to Stamp Duty, as follows:

(a) for loans with a maturity equal to or higher than five years, a rate of 0.5% shall be applied, in addition to the fixed fee charged by the notary to certify the signatures;

(b) for loans with a maturity of more than one and less than five years, a rate of 0.4% shall be applied, in addition to the fixed fee charged by the notary to certify the signatures; and

(c) for loans with a maturity of no more than one year, a rate of 0.03% shall be applied, in addition to the fixed fee charged by the notary to certify the signatures.

3.10 Do the filing, notification or registration requirements in relation to security over different types of assets involve a significant amount of time or expense?

The filing, notification and registration procedures can be more efficient and may not take a significant amount of time, but it will depend on the amounts involved and the location where these acts are performed, as timeframes may vary if such acts are performed in Maputo (the capital) or in other provinces.

3.11 Are any regulatory or similar consents required with respect to the creation of security?

No regulatory or similar consents apply, except for assets held by state-owned entities or shares of concessionaires of public services, which must be assessed on a case-by-case basis.

In case a foreign lender entity is involved, the creation of security is subject to the Bank of Mozambique's prior authorisation.

3.12 If the borrowings to be secured are under a revolving credit facility, are there any special priority or other concerns?

No, there are not.

3.13 Are there particular documentary or execution requirements (notarisation, execution under power of attorney, counterparts, deeds)?

Yes, the creation of security over real estate requires the execution of a deed, usually made before a notary, as well as pledge of shares.

In case power of attorneys are required for the execution of these acts, it shall also be granted before a public notary, and if the power of attorney is to be executed outside Mozambique, it shall be duly legalised before the Ministry of Foreign Affairs and the competent Mozambican Consulate. The execution of a deed in Mozambique before a notary requires the parties (whether Mozambican or foreign entities) to have a legal entity and tax identification number. The provision of such number is also required for the registration of a security interest in favour of a given entity.

4 Financial Assistance

4.1 Are there prohibitions or restrictions on the ability of a company to guarantee and/or give security to support borrowings incurred to finance or refinance the direct or indirect acquisition of: (a) shares of the company; (b) shares of any company which directly or indirectly owns shares in the company; or (c) shares in a sister subsidiary?

(a) Shares of the company

We understand that a company cannot acquire shares of the company, which can be expressed by the articles of association, although few exceptions apply.

(b) Shares of any company which directly or indirectly owns shares in the company

No express prohibition exists; however, corporate powers of the company may be restricted in respect of granting of guarantees or security – please see question 2.1 above.

(c) Shares in a sister subsidiary

No express prohibition exists, but please note that the corporate powers of the company may be restricted in respect of granting of guarantees or security – please see question 2.1 above.

5 Syndicated Lending/Agency/Trustee/Transfers

5.1 Will your jurisdiction recognise the role of an agent or trustee and allow the agent or trustee (rather than each lender acting separately) to enforce the loan documentation and collateral security and to apply the proceeds from the collateral to the claims of all the lenders?

In Mozambique, the system is more limited, as the agent, if it is to have the benefit of security under Mozambican law, can only render its services if previously recognised and authorised by the Bank of Mozambique, as set by the Law of Credit Institutions and Financial Companies.

5.2 If an agent or trustee is not recognised in your jurisdiction, is an alternative mechanism available to achieve the effect referred to above which would allow one party to enforce claims on behalf of all the lenders so that individual lenders do not need to enforce their security separately?

Yes, powers of attorney may be given to one creditor to enforce the claims against debtors.

5.3 Assume a loan is made to a company organised under the laws of your jurisdiction and guaranteed by a guarantor organised under the laws of your jurisdiction. If such loan is transferred by Lender A to Lender B, are there any special requirements necessary to make the loan and guarantee enforceable by Lender B?

Yes, notice to the borrower and guarantor of the assignment is required, as well as registration of the security (if subject to registration) with the relevant registry (land registry, commercial registry, car registry, financial intermediary or company books, *Central de Registo de Garantias Mobiliárias*, as applicable).

In addition, please note that the assignment of security against a company which is in an insolvency proceeding will, from a practical perspective, also require notification to the court of the assignment so that the new creditor can be recognised in the insolvency proceeding.

However, please note that there might be situations in which the guarantee may not be assigned. For example, if the parties have restricted the ability of the guarantor to assign, or if the guarantee has been provided *intuitu personae* (i.e. the nature of the guarantee is not separable from the person or the borrower).

6 Withholding, Stamp and Other Taxes; Notarial and Other Costs

6.1 Are there any requirements to deduct or withhold tax from (a) interest payable on loans made to domestic or foreign lenders, or (b) the proceeds of a claim under a guarantee or the proceeds of enforcing security?

The Corporate Income Tax ("CIT") must be withheld upon the payment of the interest on loans made to domestic or foreign lenders. Interest payments between resident companies are subject to CIT withholding at the rate of 20%, except in the situation where the creditor is a bank. Interest derived from treasury bonds and public securities listed on the Mozambique Stock Exchange are subject to CIT withholding at a reduced rate of 10%. Nevertheless, certain exemptions from CIT withholding may apply in the following scenarios:

(i) interest or similar payment in respect of loans, credit or arrears in payment, accruing to credit institutions resident for tax purposes in Mozambique, subject to CIT in respect of such interest, even if exempt regarding the same; and

(ii) interest or any increase in value, deriving from the extension of the maturity date or arrears in payment, when such credit results from sales or services provided by corporate persons or other entities that are subject to CIT in respect of such interest or increase.

In case of payment of interest on loans made to foreign lenders, the entity resident in Mozambique, upon the payment of the interest, must withhold CIT at a rate of 20%, being the final tax.

As regards proceeds of a claim under a guarantee or the proceeds of enforcing security, there are no specific withholding tax rules.

In fact, in case of issuance of guarantees, namely mortgages, bank guarantees, securities and pledges (unless ancillary to a contract already subject to stamp duty), the following rates apply: 0.02% a month for each month or part thereof, 0.2% and 0.3% a year on the amount involved, depending on whether or not the repayment period is less than one year, less than five years, or more than five years, respectively.

6.2 What tax incentives or other incentives are provided preferentially to foreign lenders? What taxes apply to foreign lenders with respect to their loans, mortgages or other security documents, either for the purposes of effectiveness or registration?

There are no tax incentives provided preferentially to foreign lenders. There are tax incentives foreseen in the Tax Benefits Code that are only applicable to investment under the investment legislation, namely regarding a general incentive scheme and a specific investment scheme regarding specific sectors of activity, but that are not specifically related to loans.

As regards taxes applicable to foreign lenders, please see our comments above in question 6.1. In addition, please bear in mind that the granting of a loan or credit arrangement is subject to Stamp Duty, as follows:

(i) Loan or credit arrangement for less than one year: 0.03% a month or part thereof.

(ii) Loan or credit arrangement for one to five years: 0.4% a year.

(iii) Loan or credit arrangement for five or more years: 0.5% a year.

6.3 Will any income of a foreign lender become taxable in your jurisdiction solely because of a loan to, or guarantee and/or grant of, security from a company in your jurisdiction?

No. A non-resident entity, such as a foreign lender, is only subject to taxation in Mozambique for the income obtained in this territory.

6.4 Will there be any other significant costs which would be incurred by foreign lenders in the grant of such loan/guarantee/security, such as notarial fees, etc.?

Foreign lenders are subject to the same costs as the national lenders, which are notarial and registration fees, as well as taxes.

6.5 Are there any adverse consequences for a company that is a borrower (such as under thin capitalisation principles) if some or all of the lenders are organised under the laws of a jurisdiction other than your own? Please disregard withholding tax concerns for purposes of this question.

No, there are not.

7 Judicial Enforcement

7.1 Will the courts in your jurisdiction recognise a governing law in a contract that is the law of another jurisdiction (a "foreign governing law")? Will courts in your jurisdiction enforce a contract that has a foreign governing law?

In accordance with the general principle set out in the Mozambican Civil Code, the parties to an agreement may elect the law governing the agreement, provided that such election corresponds to a serious interest of the parties or is the law of a jurisdiction which has a connection with the agreement, is legitimate in the context of the principles of private international law, does not refer to non-waivable rights or land rights over properties located in Mozambique, nor to insolvency procedures or as to the validity or enforceability of corporate resolutions from concerned Mozambican legal entities.

In case there is a choice of court clause, the Mozambican courts cannot enforce a contract which shall be made in the chosen jurisdiction. After the issuance of the enforceable judgment, the court sentence can be confirmed in the Mozambican court for the recognition of the enforceable judgment.

7.2 Will the courts in your jurisdiction recognise and enforce a judgment given against a company in New York courts or English courts (a "foreign judgment") without re-examination of the merits of the case?

The recognition and enforcement of judgments can be made, although it is subject to a special process of recognition of judgments, which can be subject to appeal.

7.3 Assuming a company is in payment default under a loan agreement or a guarantee agreement and has no legal defence to payment, approximately how long would it take for a foreign lender to (a) assuming the answer to question 7.1 is yes, file a suit against the company in a court in your jurisdiction, obtain a judgment, and enforce the judgment against the assets of the company, and (b) assuming the answer to question 7.2 is yes, enforce a foreign judgment in a court in your jurisdiction against the assets of the company?

It is very difficult to provide estimations on how long it will take as there are no legal deadlines established for this purpose.

7.4 With respect to enforcing collateral security, are there any significant restrictions which may impact the timing and value of enforcement, such as (a) a requirement for a public auction, or (b) regulatory consents?

Enforcement of securities must be made through the courts which procedure can delay as court proceedings are not very expedited.

7.5 Do restrictions apply to foreign lenders in the event of (a) filing suit against a company in your jurisdiction, or (b) foreclosure on collateral security?

No; in principle, no such restrictions will apply.

7.6 Do the bankruptcy, reorganisation or similar laws in your jurisdiction provide for any kind of moratorium on enforcement of lender claims? If so, does the moratorium apply to the enforcement of collateral security?

Yes, pursuant to the Mozambican Insolvency Code, the commencement of an insolvency proceeding will suspend all enforcement proceedings regarding collateral security.

7.7 Will the courts in your jurisdiction recognise and enforce an arbitral award given against the company without re-examination of the merits?

Although Mozambique is party to the New York Arbitration Convention, the country reserves that any arbitral award given in another contracting state will only be recognised without re-examination of the merits of the claim on the basis of reciprocity, where the arbitral awards have been pronounced in the territory of another contracting state.

Regarding any arbitral decision given in a state which is not party to the New York Arbitration Convention, its enforcement is subject to re-examination of the merits.

8 Bankruptcy Proceedings

8.1 How does a bankruptcy proceeding in respect of a company affect the ability of a lender to enforce its rights as a secured party over the collateral security?

In accordance with the Mozambican Insolvency Code, the commencement of insolvency proceedings will suspend all enforcement proceedings against the company and the debtor will be unable to carry on its business activity.

According to the applicable regime, securities over the debtor's assets shall be enforced within the bankruptcy proceedings.

8.2 Are there any preference periods, clawback rights or other preferential creditors' rights (e.g., tax debts, employees' claims) with respect to the security?

Under the Mozambican Insolvency Code, creditors are usually paid in the following order:

(i) employment credits;

(ii) secured credits;

(iii) tax credits;

(iv) ordinary credits;

(v) contractual and tax penalties; and

(vi) subordinated credits.

In case of different securities granted over the same asset, the first creditor shall be paid first, and the rest will follow under the same criteria.

The regime also provides for preferential creditors such as court fees, tax debts and employment claims.

8.3 Are there any entities that are excluded from bankruptcy proceedings and, if so, what is the applicable legislation?

Yes, the Mozambican Republic and public companies are excluded from the bankruptcy proceedings.

8.4 Are there any processes other than court proceedings that are available to a creditor to seize the assets of a company in an enforcement?

No, please refer to the answer provided in question 8.1.

9 Jurisdiction and Waiver of Immunity

9.1 Is a party's submission to a foreign jurisdiction legally binding and enforceable under the laws of your jurisdiction?

Yes, it is. Parties may choose to be bind under a foreign jurisdiction – please refer to question 7.1 above.

9.2 Is a party's waiver of sovereign immunity legally binding and enforceable under the laws of your jurisdiction?

In the event that an entity benefits from sovereign immunity, waiver of such benefit will not be valid in Mozambique.

10 Licensing

10.1 What are the licensing and other eligibility requirements in your jurisdiction for lenders to a company in your jurisdiction, if any? Are these licensing and eligibility requirements different for a "foreign" lender (i.e. a lender that is not located in your jurisdiction)? In connection with any such requirements, is a distinction made under the laws of your jurisdiction between a lender that is a bank *versus* a lender that is a non-bank? If there are such requirements in your jurisdiction, what are the consequences for a lender that has not satisfied such requirements but has nonetheless made a loan to a company in your jurisdiction? What are the licensing and other eligibility requirements in your jurisdiction for an agent under a syndicated facility for lenders to a company in your jurisdiction?

A foreign lender must be duly accredited to be recognised in Mozambique to provide financial services. According to the Law of Credit Institutions and Financial Companies, banks are deemed as credit institutions, which are the only institutions able to provide credits and other financial services, as described in the referred law.

A lender who provides loans without meeting the legal requirements is subject to administrative penalties and criminal liability which will be assessed under the Law of Credit Institutions and Financial Companies and the Criminal Code.

11 Other Matters

11.1 Are there any other material considerations which should be taken into account by lenders when participating in financings in your jurisdiction?

We believe that the questions above fairly address the main material issues that arise generally in the context of lending transactions.

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Gonçalo dos Reis Martins has gained a comprehensive experience over the last 15 years in advising leading international and domestic investment and retail banks, other financial institutions and asset managers in a wide range of transactions, including syndicated loans for Portuguese blue chip corporates, asset finance transactions for the oil industry, project finance, direct lending, multi-jurisdictional supply chain finance transactions and Islamic finance work. He has also been involved in the development of the contractual framework in offering by banks of new technology-based products for retail clients as well as in the engagement of Portuguese banks by Fintech companies.

Before joining PLMJ he worked in another leading Portuguese law firm and a valuable international experience, having been seconded to the Capital Markets department of Simmons & Simmons and Morgan Stanley's Legal Department (Fixed Income Division), both in London.

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Nuno Morgado Pereira is an associate lawyer of PLMJ, in Lisbon, and a member of the banking and finance department of TTA law firm, in Maputo. Nuno's practice covers a broad range of banking & finance and foreign investment matters, since he has been involved in a large proportion of the firm's recent financial transactions, public-private partnerships and project finance matters, including real estate investment projects, oil & gas projects and industrial-related projects. His experience includes construction, corporate, finance and commercial contracts and special ability dealing with the Bank of Mozambique, in relation to not only regulatory control matters, but also foreign exchange regulation, since he also holds a Master's degree in Public and Administrative Law.

Nuno obtained his law degree from Universidade Nova de Lisboa in 2011, and his Master's degree from Universidade Católica Portuguesa, in 2013. He has also been entitled to practise under both Portuguese and Mozambican law as a member of the Portuguese and Mozambican Bar Associations since 2015 and 2016, respectively.

TTA is a law firm that brings together a group of leading Mozambican professionals who share extensive knowledge of the local legal world and a culture of international legal service. What unites this team is a common interest and satisfaction in working in and for Mozambique, in strict compliance with the rules of professional ethics of the Mozambican bar association.

The professionals that make up the TTA team are lawyers drawn from different areas of legal practice, with extensive experience in the provision of specialised legal services and broad technical knowledge of local and international realities, who bring strong skills that ensure the best results for clients.

Through this team, TTA aims to make a difference by combining the highest professional standards and levels of commitment to achieve the objectives laid down by their clients TTA has an unparalleled capacity to provide services that are second to none in compliance with the applicable rules of professional ethics and while also dedicating themselves to a number of social responsibility projects.

Netherlands

Tom Ensink

Ploum

Alette Brehm

1 Overview

1.1 What are the main trends/significant developments in the lending markets in your jurisdiction?

The market remains liquid and the financing conditions for borrowers are still very favourable. We still see an increasing number of alternative lenders entering the market and providing funds.

1.2 What are some significant lending transactions that have taken place in your jurisdiction in recent years?

We have seen numerous closings in the market. Some significant examples include:

- ING's €165 million financing of Outdoor Life Group's buyout by NPM Capital.
- ABN AMRO's lead €1 billion financing of Noble Group.
- EIB's financing of €350 million of Schiphol Airport's expansion.

2 Guarantees

2.1 Can a company guarantee borrowings of one or more other members of its corporate group (see below for questions relating to fraudulent transfer/financial assistance)?

A company can in principle guarantee borrowings of one or more other members of its corporate group if the corporate objects clause in the articles of association include such issuance of guarantees. However, please refer to the restrictions set out in questions 2.2–2.5 and the financial assistance prohibition set out in question 4.1.

2.2 Are there enforceability or other concerns (such as director liability) if only a disproportionately small (or no) benefit to the guaranteeing/securing company can be shown?

Under Dutch law, uncertainty exists to some degree as to whether the issuance of a guarantee by a company for the debts of third parties can be regarded to be in furtherance of the objects of that company, and for that reason voidable or unenforceable under Dutch law. The Dutch Supreme Court has ruled that in determining this, not only a) the description of the objects in its articles of association is decisive, but b) all (relevant) circumstances must be taken into account, in particular whether the interests of the legal entity were served by the transaction.

However, the general rule in practice seems to be that accepting joint and several liability will generally serve the interest of an individual group company. Jurisprudence supports the fact that the group interest will serve the individual corporate interest. Relevant factors to consider (although no formal requirements) are: (i) whether the company who accepts joint and several liability itself may use (part of) the credit facility; (ii) whether the joint and several liability would cause an foreseeable threat to the continuity of the company and its business (e.g. as a result of the deplorable financial situation of other group companies or extreme differences in risk profiles of the business); and (iii) whether there is reciprocity between the group companies (i.e. every group company accepts the same joint and several liability, although this is not a formal requirement).

If the guarantee would endanger the continuity of the business, there is also the danger that the guarantee may be prejudicial to the position of present or future creditors. If this is the case, then the guarantee could be voided by creditors or the bankruptcy trustee of the guarantor on the basis of fraudulent preference or *actio pauliana*. Providing a guarantee that is voidable for *actio pauliana* or fraudulent preference may also lead to directors' liability.

2.3 Is lack of corporate power an issue?

Lack of corporate power may be an issue; a legal act is voidable if, due to such act, the purpose of the legal person as described in the objects clause has been exceeded and the counterparty was aware or should have been aware thereof without any personal investigation; only the legal person (or if the Dutch company goes bankrupt, the bankruptcy trustee) may invoke this ground of voidability.

2.4 Are any governmental or other consents or filings, or other formalities (such as shareholder approval), required?

No governmental consents or filings are required for issuing a company guarantee. The issuance of the guarantee must be approved by the management board. In addition, shareholder approval and/or supervisory board approval may be required if that is provided for in the articles of association of the company. Also, a works council (if any) may have the right to advise on the issuance of the guarantee.

2.5 Are net worth, solvency or similar limitations imposed on the amount of a guarantee?

Dutch law does not provide net worth, solvency or similar limitations on the amount of a guarantee. However, please refer to our answer to question 2.2.

2.6 Are there any exchange control or similar obstacles to enforcement of a guarantee?

No, there are not.

3 Collateral Security

3.1 What types of collateral are available to secure lending obligations?

The most common types of collateral are pledges on shares, moveable assets, receivables and mortgages on real estate or registered property. Also IP rights, insurance policies and bank accounts can be pledged. Certain subsidy grants, such as subsidies for sustainable energy, are also capable of being pledged.

3.2 Is it possible to give asset security by means of a general security agreement or is an agreement required in relation to each type of asset? Briefly, what is the procedure?

We do not have a general security agreement in the Netherlands. This means that each (type of) asset has to be pledged (in case of moveable property or rights) or mortgaged (in case of real estate or registered property) individually. Under Dutch law, the formalities to be taken into account by creating a security right differ according to the type of asset. Please note that a right of pledge on shares need to be vested by means of a notarial deed of pledge.

It is, however, common to combine various types of pledged assets in one deed which is then sometimes referred to as an 'omnibus pledge deed'.

3.3 Can collateral security be taken over real property (land), plant, machinery and equipment? Briefly, what is the procedure?

Security over real property located in the Netherlands is created pursuant to a notarial deed of mortgage (*hypotheek*) executed before a Dutch civil law notary. The notarial deed must be registered with the Dutch Land Registry Office (*Kadaster*).

The ownership of cables and pipelines can be established by way of a right of *superficies* (underground or overground) or as the registration of a network/grid (underground), followed by registration with the Dutch Land Registry Office (*Kadaster*). Both the right of *superficies* and the ownership of a registered network/grid are real rights and can be encumbered with a mortgage.

Security over moveable assets (such as plant, machinery and equipment) located in the Netherlands can be created as (i) a possessory pledge (*vuistpand*), or (ii) a non-possessory pledge (*bezitloos pandrecht*).

Possessory pledges are rarely created, as they require the pledgee to take possession of the pledged moveable asset. A non-possessory pledge is created pursuant to a private deed of pledge. A non-possessory pledge can be created in two different ways: (i) by a notarial deed; or (ii) by a private deed of pledge which must be registered with the Dutch Tax Authorities (for date stamping purposes only). It is common practice to create a non-possessory pledge in the latter form, i.e. as a private deed of pledge to be subsequently registered.

3.4 Can collateral security be taken over receivables? Briefly, what is the procedure? Are debtors required to be notified of the security?

Security over receivables can be created as (i) a disclosed pledge (*openbaar pandrecht*), or (ii) an undisclosed pledge (*stil pandrecht*).

A disclosed pledge of receivables is created by a private deed of pledge and notice of the right of pledge to the debtor of the pledged receivables. An undisclosed pledge of receivables can be created in two different ways, without notifying the debtors: (i) by a notarial deed; or (ii) by a private deed of pledge which must be registered with the Dutch Tax Authorities (for date stamping purposes only). It is common practice to create an undisclosed pledge in the latter form, i.e. as a private deed of pledge to be subsequently registered.

An important limitation of an undisclosed pledge is that, unlike a disclosed pledge, an undisclosed pledge can only be created over existing receivables and future receivables which directly derive from a legal relationship existing at the time of the execution of the pledge deed. In order to ensure that these future receivables are also covered under an undisclosed pledge, it is necessary to periodically execute supplemental deeds to be registered with the Dutch Tax Authorities. In practice, many Dutch banks have now introduced the concept that only a 'master pledge document' is created, in which the pledgor empowers the bank to register supplemental deeds. The bank subsequently registers one supplemental deed on behalf of all of its customers.

3.5 Can collateral security be taken over cash deposited in bank accounts? Briefly, what is the procedure?

It is common practice to create a disclosed pledge over bank (credit) accounts. For various reasons (one of them being that pursuant to the Dutch general banking conditions, a Dutch account bank has certain security interests in the bank account, such as a right of pledge and a right of set-off) it is advisable to have the account bank co-operate with the creation of such a disclosed pledge.

3.6 Can collateral security be taken over shares in companies incorporated in your jurisdiction? Are the shares in certificated form? Can such security validly be granted under a New York or English law-governed document? Briefly, what is the procedure?

A distinction should be made between registered shares in a Dutch private company with limited liability (*besloten vennootschap met beperkte aansprakelijkheid* or *BV*) and a Dutch public company with limited liability (*naamloze vennootschap* or *NV*) that can have registered or bearer shares (*aandelen aan toonder*). Bearer shares are very rare these days.

A pledge of registered shares in a BV or an NV is created by a notarial deed executed before a Dutch civil law notary. However, the articles of association may prohibit or restrict the creation of a right of pledge over shares and/or the transfer of voting rights attached to the shares, in which case the articles of association have to be amended.

In general, the notarial deed of shares will provide that the shareholder remains entitled to collect dividends and to exercise its voting rights until the occurrence of an event of default and notice given thereof by the pledgee.

The (registered) shares are not in certificated form, but registered in the shareholders' register of the BV or NV.

The procedure set out under question 2.2 above with respect to moveable assets applies *mutatis mutandis* to a pledge of bearer shares held or deposited in the Netherlands.

Shares can also be deposited in a securities account and pledged in this form. A right of pledge over securities which are transferable through book entries under the Dutch Securities (Bank Giro Transactions) Act (*Wet giraal effectenverkeer*) is created by a book entry in the name of the pledgee by the custodian bank.

Security over shares in Dutch companies cannot be validly granted under a New York or English law-governed document.

3.7 Can security be taken over inventory? Briefly, what is the procedure?

Inventory is a form of moveable asset. Security over moveable assets (such as plant, machinery and equipment) located in the Netherlands can be created as a possessory pledge or a non-possessory pledge. See also question 3.3.

3.8 Can a company grant a security interest in order to secure its obligations (i) as a borrower under a credit facility, and (ii) as a guarantor of the obligations of other borrowers and/or guarantors of obligations under a credit facility (see below for questions relating to the giving of guarantees and financial assistance)?

Yes, if and to the extent that the corporate objects of the company includes such transaction and it is within the corporate interest of the company. For the NV it is also a requirement that the transaction does not constitute financial assistance.

3.9 What are the notarisation, registration, stamp duty and other fees (whether related to property value or otherwise) in relation to security over different types of assets?

Notarial fees are involved in relation to a mortgage or a pledge of registered shares, which must be laid down in a notarial deed that will be executed before a Dutch civil law notary. Notarial fees are not regulated and not dependent upon, e.g., the deal value. It is possible to make an individual agreement with a Dutch civil law notary. The notarial fees in the Netherlands are regarded as reasonable, especially in comparison with other jurisdictions in which the fee amount is based on the deal value.

The mortgage of real estate must also be laid down in a notarial deed for which a notarial fee is charged. Furthermore, the Dutch Land Registry Office (*Kadaster*) will charge a (nominal) fee for the mandatory registration of the mortgage with the Dutch Land Registry Office (*Kadaster*).

There are no stamp duties on security rights over assets. For the sake of completeness, the only stamp duty-type taxes are real estate transfer tax (not for mortgages or transfer of grids) and insurance premium tax.

3.10 Do the filing, notification or registration requirements in relation to security over different types of assets involve a significant amount of time or expense?

No, they do not.

3.11 Are any regulatory or similar consents required with respect to the creation of security?

There might be consents required for the mortgage over real property, especially when it concerns real rights that are to be encumbered with a mortgage. Depending on the specific conditions under which the real rights are established, it is possible that the landowner will have to give its consent. Furthermore, should the real property already be encumbered with another right of mortgage, this mortgage-holder shall have to consent as well.

For the pledge of subsidy grants for sustainable energy, it is advisable to request a consent from the state, but in practice most of the subsidy grants are pledged without consent.

3.12 If the borrowings to be secured are under a revolving credit facility, are there any special priority or other concerns?

No, there are not.

3.13 Are there particular documentary or execution requirements (notarisation, execution under power of attorney, counterparts, deeds)?

Security over shares and real property are created pursuant to a notarial deed.

4 Financial Assistance

4.1 Are there prohibitions or restrictions on the ability of a company to guarantee and/or give security to support borrowings incurred to finance or refinance the direct or indirect acquisition of: (a) shares of the company; (b) shares of any company which directly or indirectly owns shares in the company; or (c) shares in a sister subsidiary?

(a) Shares of the company

Financial assistance prohibitions apply to the NV. An NV may not provide security, give a price guarantee or otherwise bind itself, whether jointly and severally or otherwise with or for third parties with a view to the subscription or acquisition by third parties of shares in its share capital or depository receipts. Such prohibition also applies to its subsidiaries. Sometimes the articles of association of a BV still include provisions regarding financial assistance. It is advisable to amend these articles of association prior to entering into a transaction.

(b) Shares of any company which directly or indirectly owns shares in the company

The financial assistance prohibition also applies to subsidiaries of the NV, even if the subsidiary is a BV.

(c) Shares in a sister subsidiary

The financial assistance prohibition does not apply to sister subsidiaries.

5 Syndicated Lending/Agency/Trustee/Transfers

5.1 Will your jurisdiction recognise the role of an agent or trustee and allow the agent or trustee (rather than each lender acting separately) to enforce the loan documentation and collateral security and to apply the proceeds from the collateral to the claims of all the lenders?

Dutch law itself does not recognise the concept of a 'trust', but it will recognise the role of a security trustee/agent if duly established and existing under the laws of another jurisdiction. However, pursuant to Dutch law, it is generally assumed that security can only be created in favour of the creditor(s) of the claim (see question 5.2 below).

5.2 If an agent or trustee is not recognised in your jurisdiction, is an alternative mechanism available to achieve the effect referred to above which would allow one party to enforce claims on behalf of all the lenders so that individual lenders do not need to enforce their security separately?

To allow a trustee or agent to hold and enforce security rights on behalf of the lenders, it is common use to insert a 'parallel debt' in the finance documentation (preferably the loan agreement or intercreditor agreement). A parallel debt constitutes a separate (but not double) claim from the borrower and/or guarantor to the security trustee or agent for an amount equal to the amount owed to the syndicated lenders. Any payment by the borrower to the security trustee or agent (or proceed recovered from security) in respect of the parallel debt equally discharges the borrower's debt to the lenders.

5.3 Assume a loan is made to a company organised under the laws of your jurisdiction and guaranteed by a guarantor organised under the laws of your jurisdiction. If such loan is transferred by Lender A to Lender B, are there any special requirements necessary to make the loan and guarantee enforceable by Lender B?

In principle, Dutch private international law follows the applicable law in the loan and the guarantee. Assuming Dutch law is applicable, in general, a deed between Lender A and Lender B is essential. In addition, co-operation with the deed in the form of co-signature of the Dutch borrower and the guarantor is advisable. If co-signature is not possible, there are possibly other ways to ensure the transfer, depending on the wording of the deed and by what could be argued as 'cooperation with the transfer' by the borrower and the guarantor.

6 Withholding, Stamp and Other Taxes; Notarial and Other Costs

6.1 Are there any requirements to deduct or withhold tax from (a) interest payable on loans made to domestic or foreign lenders, or (b) the proceeds of a claim under a guarantee or the proceeds of enforcing security?

There is generally no withholding tax on (a) interest payable on loans made to domestic or foreign lenders, or (b) the proceeds of a claim under a guarantee or the proceeds of enforcing security. However, interest on long-term subordinated profit-sharing loans may be treated as a dividend. If so, a 15% withholding tax may apply.

Please note that a withholding tax on interest paid to related parties residing in tax haven countries has been announced for 2020.

6.2 What tax incentives or other incentives are provided preferentially to foreign lenders? What taxes apply to foreign lenders with respect to their loans, mortgages or other security documents, either for the purposes of effectiveness or registration?

There are no formal incentives that apply specifically to foreign investors or creditors. However, it is important to know that foreign investors can discuss their Dutch tax position in advance with the Dutch Tax Authorities and obtain a binding tax ruling. A government agency, the Netherlands Foreign Investment Agency (http://www.nfia.nl), can provide information on this subject.

Foreign investors are subject to Dutch (corporate) income tax on income from Dutch sources. Except for wage withholding tax (on wages, salaries and certain other remunerations for labour of individuals) and dividend withholding tax, no withholding taxes apply on payments to non-residents.

Dutch investors are subject to Dutch income tax on their worldwide income. However, foreign-source income generally may benefit from an exemption or credit to avoid international double taxation. The most important exemptions are income and gains from qualifying subsidiaries (participation exemption), foreign enterprises (permanent establishment exemption) and foreign real properties.

6.3 Will any income of a foreign lender become taxable in your jurisdiction solely because of a loan to, or guarantee and/or grant of, security from a company in your jurisdiction?

No. However, in very specific situations a non-resident lender may be subject to non-resident corporate income tax or personal income tax.

A legal entity or other entity treated as a corporate taxpayer will be subject to non-resident corporate income tax only if it holds, whether directly or indirectly, the ownership of, or certain other rights over, shares representing 5% or more of the total issued and outstanding capital of the borrower (or the issued and outstanding capital of any class of shares), or rights to acquire shares, whether or not already issued, that represent at any time 5% or more of the total issued and outstanding capital of the Company (or the issued and outstanding capital of any class of shares) or the ownership of certain profit participating certificates that relate to 5% or more of the annual profit and/or to 5% or more of our liquidation proceeds and this structure is seen as established with one of its main purposes to avoid taxation.

An individual will be subject to non-resident personal income tax only if it holds, whether directly or indirectly, alone or together with certain family members and/or his partner the ownership of, or certain other rights over: shares representing 5% or more of the total issued and outstanding capital of the borrower (or the issued and outstanding capital of any class of shares); or rights to acquire shares, whether or not already issued, that represent at any time 5% or more of the total issued and outstanding capital of the Company (or the issued and outstanding capital of any class of shares); or the ownership of certain profit participating certificates that relate to 5% or more of the annual profit and/or to 5% or more of our liquidation proceeds or held such shareholding and this shareholding is not a business asset of a businesses carried out by the lender. If an individual held such shareholding and disposed of it, applying a roll-over relief, the same rule continues to apply.

6.4 Will there be any other significant costs which would be incurred by foreign lenders in the grant of such loan/guarantee/security, such as notarial fees, etc.?

No, there will be no other significant costs.

6.5 Are there any adverse consequences for a company that is a borrower (such as under thin capitalisation principles) if some or all of the lenders are organised under the laws of a jurisdiction other than your own? Please disregard withholding tax concerns for purposes of this question.

There are no tax rules that make a distinction for the borrower between a foreign lender and a domestic lender.

7 Judicial Enforcement

7.1 Will the courts in your jurisdiction recognise a governing law in a contract that is the law of another jurisdiction (a "foreign governing law")? Will courts in your jurisdiction enforce a contract that has a foreign governing law?

In proceedings for the enforcement of the obligations of the parties under a contract, the courts of the Netherlands would give effect to the choice of law made in such documents on the basis and within the scope of, and subject to the limitations imposed by Regulation (EC) 593/2008 of 17 June 2008 ('Rome I').

The express choice of foreign law to govern non-contractual obligations between the parties under a contract is subject to Regulation (EC) 864/2007 of 11 July 2007 ('Rome II') and to those obligations being within the scope of and the choice permitted by Rome II, and may be subject to challenge pursuant to Rome II.

7.2 Will the courts in your jurisdiction recognise and enforce a judgment given against a company in New York courts or English courts (a "foreign judgment") without re-examination of the merits of the case?

Subject to any Brexit changes, the following applies: a judgment obtained in a English court against a company, which is enforceable in England, will be recognised and enforced in the Netherlands without re-trial or re-examination of the merits, on the basis of and within the scope of, and subject to the limitations imposed by Regulation (EC) 1215/2012 (the "Brussels Ibis Regulation"), the DCC, the DCCP, the Dutch Bankruptcy Act, the Commercial Code and the rules of civil procedure as applied by the courts of the Netherlands.

A judgment obtained in a New York court is not directly enforceable in the Netherlands, because there is no applicable convention to which both the Netherlands and the United States are a party. If the party in favour of whom a New York judgment has been issued wishes to enforce such judgment, that party must obtain a judgment which is enforceable in the Netherlands. A possibility is to initiate proceedings before the Dutch court (article 431 paragraph 2 DCCP). Such a procedure can in many cases remain without re-examination of the merits of the case. The starting point is that, if the foreign court's judgment is submitted in the Dutch procedure, the judge is free to criticise whether the judgment should be recognised or not. If the judgment meets the conditions for recognition in the Netherlands, the judge will in principle condemn the convicted party to what it was already convicted to in the foreign judgment.

A foreign judgment can be recognised in the Netherlands if the following conditions are met: (i) the foreign court has jurisdiction on an internationally accepted ground; (ii) the judicial procedure which has led to the judgment was appropriately followed according to Dutch standards (e.g. timely and proper convocation); (iii) the foreign judgment does not conflict with Dutch public order; and (iv) the foreign judgment does not conflict with a judgment of a Dutch judge or a previous judgment of a foreign court that is eligible for recognition in the Netherlands. In addition, the foreign judgment between the same parties must have been given in a dispute that concerns the same subject and is based on the same cause. Of course it is also required that the judgment is enforceable in the foreign court's country and that there is no possibility to file for appeal.

7.3 Assuming a company is in payment default under a loan agreement or a guarantee agreement and has no legal defence to payment, approximately how long would it take for a foreign lender to (a) assuming the answer to question 7.1 is yes, file a suit against the company in a court in your jurisdiction, obtain a judgment, and enforce the judgment against the assets of the company, and (b) assuming the answer to question 7.2 is yes, enforce a foreign judgment in a court in your jurisdiction against the assets of the company?

Assuming that the foreign lender has an urgent interest (*spoedeisend belang*), the foreign lender can institute preliminary relief proceedings against the company and ask for a provisional measure by way of injunctive relief. After a summons for preliminary relief has been issued, the court shall arrange a court session (in most cases, this session shall be scheduled between two and four weeks after the issuing of the writ). At the end of the court session, the subdistrict court informs the parties when the judgment follows (this is usually within two weeks of the court session). The bailiff can directly execute such provisional judgment against the assets of the company. The company has three options: (i) accepting the judgment; (ii) starting comprehensive proceedings; or (iii) appeal. Although none of these options has suspensive effect, it must be noted that execution of a provisional judgment which is overruled can lead to liability for damages.

If there is no urgent interest demonstrable, substantive proceedings should be commenced, which proceedings shall take at least six months or quite possibly even longer, up to one year or more (especially when witness hearings are required) before the judgment can be enforced against the assets of the company.

7.4 With respect to enforcing collateral security, are there any significant restrictions which may impact the timing and value of enforcement, such as (a) a requirement for a public auction, or (b) regulatory consents?

A public auction occurs usually under supervision of a civil-law notary or a bailiff, who has to ensure that all formalities and requirements for public auction are observed.

Private sale is only allowed if the competent court has given its permission.

In general, each party who is foreclosing collateral always has the duty to mitigate damage with regard to the companies concerned. For example, under certain circumstances there may be abuse of the authority of a bank to proceed to execution. This may be the case, among other things, if the bank has no reasonable interest in the execution, also in view of the interests on the part of the debtor who will be harmed by the execution, or if there is an emergency situation on the side of the debtor.

7.5 Do restrictions apply to foreign lenders in the event of (a) filing suit against a company in your jurisdiction, or (b) foreclosure on collateral security?

No; in principle every (legal) person can file a lawsuit and foreclose on collateral security.

7.6 Do the bankruptcy, reorganisation or similar laws in your jurisdiction provide for any kind of moratorium on enforcement of lender claims? If so, does the moratorium apply to the enforcement of collateral security?

Yes, the Dutch Bankruptcy Act – applicable in both bankruptcy and during suspension of payments – provides the possibility of a (general) moratorium for no more than four months. Such a moratorium affects (temporarily) the enforcement of (collateral) security rights.

7.7 Will the courts in your jurisdiction recognise and enforce an arbitral award given against the company without re-examination of the merits?

The enforcement in the Netherlands of an arbitral award will be subject to the provisions of the Convention on the Recognition and Enforcement of Foreign Arbitral Awards of New York, 1958. Because a Dutch court may examine whether the content and the formation of an arbitral award is rendered within the scope of Dutch public order, there is a certain kind of re-examination possible. To illustrate this point, an arbitral award rendered may be ignored by a Dutch court if (i) there was no valid agreement to arbitrate, (ii) the tribunal was not duly composed or did not comply with procedural rules, (iii) the award has not been duly executed, (iv) the award does not contain the grounds for the verdict, or (v) the award was based on fraud.

8 Bankruptcy Proceedings

8.1 How does a bankruptcy proceeding in respect of a company affect the ability of a lender to enforce its rights as a secured party over the collateral security?

A bankruptcy does not affect the ability of a secured party – a mortgage holder or a pledgee – to enforce its rights, provided there is no longer a moratorium as stated in question 7.6.

8.2 Are there any preference periods, clawback rights or other preferential creditors' rights (e.g., tax debts, employees' claims) with respect to the security?

There are several parties that could have preferential rights with regard to secured assets; for instance, the Dutch Tax Authorities, local tax authorities and employees' claims with regard to seagoing vessels.

8.3 Are there any entities that are excluded from bankruptcy proceedings and, if so, what is the applicable legislation?

There is no legislation that excludes private entities from bankruptcy proceedings.

8.4 Are there any processes other than court proceedings that are available to a creditor to seize the assets of a company in an enforcement?

Dutch law is relatively liberal in obtaining a court order for freezing assets prior to having a court judgment (*conservatoir beslag*). In most of the cases, such a court order is granted *ex parte*.

If a notarial deed provides a clear obligation for a payment, the original of such deed can be enforced without legal proceedings being necessary.

9 Jurisdiction and Waiver of Immunity

9.1 Is a party's submission to a foreign jurisdiction legally binding and enforceable under the laws of your jurisdiction?

A submission to a foreign jurisdiction is valid and legally binding upon a Dutch entity under the laws of the Netherlands, as long as there is an international element to the transaction.

Notwithstanding a valid submission to a foreign jurisdiction, Dutch courts may assume jurisdiction if a plaintiff seeks provisional measures in preliminary relief proceedings, a preliminary decision or if a plaintiff files a request for the levy of a pre-trial attachment. Furthermore, it should be noted that a valid submission to a foreign jurisdiction will not restrict the application of certain overriding provisions of the laws of the Netherlands, designed for safeguarding its public interests.

Finally, it should be noted that certain proceedings, such as proceedings related to real estate or the governance of companies, have exclusive jurisdiction.

9.2 Is a party's waiver of sovereign immunity legally binding and enforceable under the laws of your jurisdiction?

From a Dutch law point of view, this is unclear. The main rule is that only the State can validly waive its immunity. It appears to be arguable that a legal person can waive immunity too after the State has assigned a particular governmental task to that legal person.

10 Licensing

10.1 What are the licensing and other eligibility requirements in your jurisdiction for lenders to a company in your jurisdiction, if any? Are these licensing and eligibility requirements different for a "foreign" lender (i.e. a lender that is not located in your jurisdiction)? In connection with any such requirements, is a distinction made under the laws of your jurisdiction between a lender that is a bank *versus* a lender that is a non-bank? If there are such requirements in your jurisdiction, what are the consequences for a lender that has not satisfied such requirements but has nonetheless made a loan to a company in your jurisdiction? What are the licensing and other eligibility requirements in your jurisdiction for an agent under a syndicated facility for lenders to a company in your jurisdiction?

In general, lenders from outside the Netherlands can lend to companies in the Netherlands without a licence. The Dutch Financial Supervision Act (*Wet op het financieel toezicht*) provides for licence requirements for parties with its registered office in the Netherlands acting as a bank. This means that lenders not having their registered office in the Netherlands and not acting through a Dutch-based branch or representative office do not need to obtain a licence. This can be different when lending to consumers. There are no specific regulatory requirements imposed on an agent other than those that apply to a lender.

11 Other Matters

11.1 Are there any other material considerations which should be taken into account by lenders when participating in financings in your jurisdiction?

The proper performance of AML checks is becoming increasingly important and this should be taken into account by both lenders as well as borrowers as this will have an impact on timing.

Under Dutch law, it is prohibited to create a security by means of a transfer of ownership (*fiduciaverbod*).

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Portugal

PLMJ

Gonçalo dos Reis Martins

1 Overview

1.1 What are the main trends/significant developments in the lending markets in your jurisdiction?

Further to the successful exit of the financial assistance programme in 2014, the Portuguese economy has been growing at an increasing pace. Such growth has fuelled a significant rise in unsecured consumer lending, as well as large-scale property finance transactions. The increase in the M&A industry has also led to an increase in acquisition finance.

1.2 What are some significant lending transactions that have taken place in your jurisdiction in recent years?

The major lending transactions in Portugal in 2018 have included vendor financing transactions in relation to disposals of NPL portfolios by Portuguese banks, real estate financing transactions and the financing of the acquisition of telecom towers by a consortium formed by Morgan Stanley Infrastructure Partners and Horizon Equity Partners from Altice Portugal.

2 Guarantees

2.1 Can a company guarantee borrowings of one or more other members of its corporate group (see below for questions relating to fraudulent transfer/financial assistance)?

As a general rule, the corporate powers of a company are restricted to those rights and obligations which are necessary or convenient for accomplishing the purpose of the company (which, generally, is to make a profit).

In accordance with Article 6(3) of the Portuguese Companies Code, there is a legal presumption that the granting of guarantees in respect of obligations of other entities is contrary to the purpose of companies, unless there is a justifiable self-interest of the company in providing the guarantee or the company in question is in a group or controlling relationship with such entity.

Such justifiable self-interest of the company is evident in the provision of downstream guarantees, but is less evident in the provision of upstream and cross-stream guarantees. In the case of upstream and cross-stream guarantees, it is advisable for the relevant resolutions to be passed justifying the self-interest of the company, which may be an indirect one, in providing the guarantee.

2.2 Are there enforceability or other concerns (such as director liability) if only a disproportionately small (or no) benefit to the guaranteeing/securing company can be shown?

In such situations, it is likely that there is no justifiable self-interest to the company in providing the guarantee/security and unless the company is in a group or controlling relationship with the entity whose obligations it guarantees/secures, the provision of the guarantee/security may be considered to be null and void.

Furthermore, in the absence of benefit or the existence of only a disproportionately small benefit to the company, the provision of the guarantee/security may be terminated in the context of an insolvency proceeding relating to the company if the guarantee/security is provided during the 12-month period prior to the declaration of insolvency.

The provision of the guarantee or security with disproportionately small (or no) benefit to the company may give rise to the breach of duties of directors towards the company and, therefore, liability.

2.3 Is lack of corporate power an issue?

Yes, please see question 2.1 above.

2.4 Are any governmental or other consents or filings, or other formalities (such as shareholder approval), required?

Except for certain state-owned and other public sector companies, unless there is a restriction contained in the articles of association of the company, in principle, no governmental approvals, consents, filings or other formalities are required by law, for a guarantee provided by a Portuguese company to be enforceable.

However, it is common practice for there to be a requirement for either shareholder approval or board approval for the granting of the guarantee. Usually, such approval will contain an express reference to the benefit to the company from the provision of the guarantee (even if such benefit is an indirect one) or to the controlling or group relationship (if any) with the entity benefiting from the provision of the guarantee.

2.5 Are net worth, solvency or similar limitations imposed on the amount of a guarantee?

No, but please see question 2.2 above as to corporate benefit.

2.6 Are there any exchange control or similar obstacles to enforcement of a guarantee?

No exchange controls or other obstacles exist in Portugal regarding the enforcement of a guarantee.

3 Collateral Security

3.1 What types of collateral are available to secure lending obligations?

There are various types of collateral available to secure lending obligations, such as:

(i) mortgage over real estate property, aircrafts, vessels, cars and industrial units (e.g. factories);

(ii) pledge over movable assets not referred to in (i) above;

(iii) pledge over a business (including inventory) – only possible if the pledgee is a credit institution;

(iv) pledge of rights (including credits and receivables);

(v) financial pledge – a pledge of cash or securities in favour of a credit institution; and

(vi) escrow of income deriving from real estate, aircraft, vessels or cars.

3.2 Is it possible to give asset security by means of a general security agreement or is an agreement required in relation to each type of asset? Briefly, what is the procedure?

In accordance with Portuguese law, the provision of general security (i.e. over the assets of a given entity generally) is considered null and void because of lack of determination of the specific assets that become subject to the security.

It is therefore necessary that a security agreement identifies, to the greatest extent possible, the assets which are subject to the security created by such agreement. At least, the security agreement must contain certain criteria which would allow the identification of the secured assets at a given time.

The use of one single agreement or separate agreements will depend on the type of security being granted, as mortgages and escrow of income must be granted by public deed, whereas the pledges may be granted by means of private agreements.

3.3 Can collateral security be taken over real property (land), plant, machinery and equipment? Briefly, what is the procedure?

Yes, collateral security may be taken over such assets by means of a deed of mortgage.

A mortgage over plant will include the real estate property and all the machinery and equipment thereof which is identified in a schedule to the deed.

3.4 Can collateral security be taken over receivables? Briefly, what is the procedure? Are debtors required to be notified of the security?

Yes, collateral security by means of a pledge over receivables may be taken. A written agreement is required, as well as notification of the creation of the pledge to the debtors, so that the pledge may be enforced against such persons.

3.5 Can collateral security be taken over cash deposited in bank accounts? Briefly, what is the procedure?

Yes. There are two types of pledge that can be taken over cash deposited in bank accounts: a pledge created under the Portuguese Civil Code; and a financial pledge.

A Portuguese Civil Code pledge is the most common form of pledge. The financial pledge, which may be created if the pledgee is a bank, provides more flexibility to the pledgor upon enforcement.

In any event, formalities include the execution of an agreement and notice to the bank where the cash is deposited (if the custody bank is not the pledgee). The acknowledgment of the pledge by the bank is not required, but is useful so as to ensure swift enforcement.

3.6 Can collateral security be taken over shares in companies incorporated in your jurisdiction? Are the shares in certificated form? Can such security validly be granted under a New York or English law governed document? Briefly, what is the procedure?

Yes, collateral security may be taken over shares in companies incorporated in Portugal as a pledge of shares.

Shares may be either in certificated form or in book-entry form. Yes, provided that any formalities required under Portuguese law for the validity and effectiveness of the pledge are complied with. The procedure will depend on the type of company in question.

If the company is a private limited liability company (*sociedade por quotas*), registration of the pledge over the shares at the Commercial Registry is required.

If the company is a public limited liability company (*sociedade anónima*), a pledge of shares of such type of company requires, if the shares are in certificate form, the annotation of the creation of the pledge on each share certificate and registration of the pledge in the books of the issuer. The creation of the pledge over book-entry shares is made by annotation of the creation of the pledge in the securities account in which the shares are deposited and registration in the books of the issuer.

3.7 Can security be taken over inventory? Briefly, what is the procedure?

Security over inventory is possible if such security is granted in favour of a credit institution. The procedure includes the execution of a written agreement. Upon default or the occurrence of other circumstances as set out in the pledge agreement, it is customary for the pledgee or security agent to give an enforcement notice to the pledgor crystallising the stock. Alternatively, parties may agree in the provision of regular notices detailing the pledged stock.

3.8 Can a company grant a security interest in order to secure its obligations (i) as a borrower under a credit facility, and (ii) as a guarantor of the obligations of other borrowers and/or guarantors of obligations under a credit facility (see below for questions relating to the giving of guarantees and financial assistance)?

Yes, but please see the restrictions on the provision of guarantees in question 2.1 above, which are also applicable in relation to the provision of security interest by companies.

3.9 What are the notarisation, registration, stamp duty and other fees (whether related to property value or otherwise) in relation to security over different types of assets?

The costs for the creation of security are, generally, as follows:

(i) notarial fees (only applicable where the execution of a public deed is required): approximately EUR 280 per deed;

(ii) registration fees: EUR 225 per property asset, if registration is requested by the notary; and

(iii) stamp duty (please see below on the applicability of stamp duty):

(a) 0.04 per cent, per month over the secured amount, in the case of security granted for a period of less than one year;

(b) 0.5 per cent, over the secured amount for security granted for a period of one year or more and less than five years; and

(c) 0.6 per cent, over the secured amount for security granted for a period of five years or more.

3.10 Do the filing, notification or registration requirements in relation to security over different types of assets involve a significant amount of time or expense?

In principle there should be no timing issues. Filings, notifications and registrations are made in a matter of a few days.

As regards expenses, these can be a considerable amount in the event that stamp duty is due on the granting of guarantees or the creation of security.

3.11 Are any regulatory or similar consents required with respect to the creation of security?

No regulatory or similar consents apply, except for assets held by state-owned entities or shares of concessionaires of public services, which must be assessed on a case-by-case basis.

3.12 If the borrowings to be secured are under a revolving credit facility, are there any special priority or other concerns?

No, there are not. In any case, please note that the creditors benefitting from *in rem security* have a privileged status in accordance with the Portuguese Insolvency Code. The fact that the credit facility is a revolving one does not affect priority or raise other concerns.

3.13 Are there particular documentary or execution requirements (notarisation, execution under power of attorney, counterparts, deeds)?

Yes, the creation of security over real estate requires the execution of a deed, usually made before a notary. In such case, the powers of attorney, if any, must also be granted before a public notary (and bear the apostille of The Hague Convention or legalised in accordance with the relevant rules, if executed outside of Portugal). The execution of a deed in Portugal before a notary requires the parties (whether Portuguese or foreign entities) to have a legal entity and tax identification number. The provision of such number is also required for the registration of a security interest in favour of a given entity.

4 Financial Assistance

4.1 Are there prohibitions or restrictions on the ability of a company to guarantee and/or give security to support borrowings incurred to finance or refinance the direct or indirect acquisition of: (a) shares of the company; (b) shares of any company which directly or indirectly owns shares in the company; or (c) shares in a sister subsidiary?

(a) Shares of the company

Yes, this is expressly forbidden in accordance with Article 322 of the Portuguese Companies Code. Few exceptions are available. The violation of this prohibition may lead to criminal liability of the directors/managers of such company and the agreement, guarantee or security interest may be declared null and void.

(b) Shares of any company which directly or indirectly owns shares in the company

No express prohibition exists, but it is generally understood as applicable. Also, please note that the corporate powers of the company may be restricted in respect of granting of guarantees or security – please see question 2.1 above.

(c) Shares in a sister subsidiary

No express prohibition exists, but please note that the corporate powers of the company may be restricted in respect of granting of guarantees or security – please see question 2.1 above.

5 Syndicated Lending/Agency/Trustee/Transfers

5.1 Will your jurisdiction recognise the role of an agent or trustee and allow the agent or trustee (rather than each lender acting separately) to enforce the loan documentation and collateral security and to apply the proceeds from the collateral to the claims of all the lenders?

The role of the agent acting on behalf of the secured creditors will be recognised in Portugal, provided that the agent is also a secured creditor, which is usually the case. This requirement derives from the fact that, under Portuguese law, only an entity which is a creditor may request the registration of the security in its own name. In such circumstances, and besides the fact that the agent is also named as secured creditor in the documentation, the documentation shall foresee that the agent will also be acting as a representative of the other creditors in enforcing the security.

The role of the trustee is not recognised in Portugal, except for the specific legal regime applicable only in the context of the Madeira International Business Centre (*Zona Franca da Madeira*).

5.2 If an agent or trustee is not recognised in your jurisdiction, is an alternative mechanism available to achieve the effect referred to above which would allow one party to enforce claims on behalf of all the lenders so that individual lenders do not need to enforce their security separately?

This is not applicable.

5.3 Assume a loan is made to a company organised under the laws of your jurisdiction and guaranteed by a guarantor organised under the laws of your jurisdiction. If such loan is transferred by Lender A to Lender B, are there any special requirements necessary to make the loan and guarantee enforceable by Lender B?

Yes, notice to the borrower and guarantor of the assignment is required, as well as registration of the security (if subject to registration) with the relevant registry (land registry, commercial registry, car registry, financial intermediary or company books, as applicable).

In addition, please note that the assignment of security against a company which is in an insolvency proceeding will, from a practical perspective, also require the notification to the court of the assignment so that the new creditor can be recognised in the insolvency proceeding.

However, please note that there might be situations in which the guarantee may not be assigned. For example, if the parties have restricted the ability of the guarantor to assign, or if the guarantee has been provided *intuitu personae* (i.e. the nature of the guarantee is not separable from the person or the borrower).

6 Withholding, Stamp and Other Taxes; Notarial and Other Costs

6.1 Are there any requirements to deduct or withhold tax from (a) interest payable on loans made to domestic or foreign lenders, or (b) the proceeds of a claim under a guarantee or the proceeds of enforcing security?

Payments of interest by a Portuguese corporate to a foreign lender will be subject to withholding tax, currently at a rate of 25 per cent, or such other reduced withholding tax rate as determined in the applicable Double Tax Treaty. The proceeds of a claim under a guarantee or the proceeds of enforcing security are not subject to withholding tax.

6.2 What tax incentives or other incentives are provided preferentially to foreign lenders? What taxes apply to foreign lenders with respect to their loans, mortgages or other security documents, either for the purposes of effectiveness or registration?

In general, there are no tax incentives for foreign lenders in the context of bank lending transactions, in contrast to the general tax exemption applicable to foreign bondholders.

However, the following specific tax incentives may apply:

(i) full or partial tax exemption in respect of interest paid by public sector entities to foreign lenders (for instance, *Schuldschein* loans); and

(ii) full tax exemption on interest paid by entities operating in the Madeira International Business Centre to foreign entities.

A loan to a Portuguese entity or a guarantee provided by a Portuguese entity will, in principle, attract stamp duty at the rates specified in question 3.9 above. However, please note that non-payment of stamp duty will not have an impact of the effectiveness of the loan or security or the valid registration of security.

6.3 Will any income of a foreign lender become taxable in your jurisdiction solely because of a loan to, or guarantee and/or grant of, security from a company in your jurisdiction?

The income of a foreign lender deriving from payments of interest will become taxable in Portugal by virtue of the borrower being considered tax resident in Portugal. Please note that, as mentioned in question 6.1 above, there will be withholding tax on the payments of interest in such situation.

6.4 Will there be any other significant costs which would be incurred by foreign lenders in the grant of such loan/guarantee/security, such as notarial fees, etc.?

There are other costs, such as notarial fees and land registry fees, for the registration of a mortgage over real estate. These will not be significant unless the security is granted over several properties. The cost of registration of a mortgage is EUR 225 per property, if the registration is submitted by a notary.

6.5 Are there any adverse consequences for a company that is a borrower (such as under thin capitalisation principles) if some or all of the lenders are organised under the laws of a jurisdiction other than your own? Please disregard withholding tax concerns for purposes of this question.

No specific adverse consequences (other than described above as to withholding tax) will arise by virtue of the lenders being incorporated outside of Portugal.

7 Judicial Enforcement

7.1 Will the courts in your jurisdiction recognise a governing law in a contract that is the law of another jurisdiction (a "foreign governing law")? Will courts in your jurisdiction enforce a contract that has a foreign governing law?

In accordance with the general principle set out in the Portuguese Civil Code, the parties to an agreement may elect the law governing the agreement, provided that such election corresponds to a serious interest of the parties or is the law of a jurisdiction which has a connection with the agreement and is legitimate in the context of the principles of private international law.

Furthermore, under the Rome I Regulation (Regulation (EC) No. 593/2008 of 17 June), the choice of foreign law is valid and will be recognised and enforceable in Portugal, unless there is a mandatory provision in the Rome I Regulation that determines the competence of Portuguese law.

7.2 Will the courts in your jurisdiction recognise and enforce a judgment given against a company in New York courts or English courts (a "foreign judgment") without re-examination of the merits of the case?

Any final judgment obtained in a competent jurisdiction in respect of any sums payable in connection with the agreements would be enforced by the courts of Portugal under the conditions set out in the (recast) Brussels Regulation (Regulation (EU) No. 1215/2012 of 20 December 2012) or the Lugano Convention of 16 September 1988 or, if and when such instruments are not applicable, would be enforced by the courts of Portugal without re-examination of the merits of the case provided that:

(a) there are no doubts about the authenticity or substance of the document in which the judgment is given, and the judgment is final and conclusive;

(b) any conditions imposed by the law of the country in which it was given, which are conditions to its enforcement in the Portuguese courts, have been complied with;

(c) it was issued by a foreign court, the jurisdiction of which had not been claimed fraudulently and does not pertain to matters subject to the exclusive competence of the Portuguese courts;

(d) it would not be adjudged *res judicata* by the Portuguese courts;

(e) the defendant was duly served for the action in accordance with the law of the country in which the judgment was issued and that the principles of the right to a fair trial (*principio do contraditório*) and equal treatment of the parties have been complied with; and

(f) it does not contravene the principles of Portuguese public order.

7.3 Assuming a company is in payment default under a loan agreement or a guarantee agreement and has no legal defence to payment, approximately how long would it take for a foreign lender to (a) assuming the answer to question 7.1 is yes, file a suit against the company in a court in your jurisdiction, obtain a judgment, and enforce the judgment against the assets of the company, and (b) assuming the answer to question 7.2 is yes, enforce a foreign judgment in a court in your jurisdiction against the assets of the company?

In general, filing a suit in Portugal, obtaining a judgment and enforcing it takes on average 30 months. Enforcing a foreign judgment in Portugal against the assets of the company could take 12 months. In both scenarios, the timeframe for enforcement of the court decision will depend on how long it takes to identify the assets to be seized.

7.4 With respect to enforcing collateral security, are there any significant restrictions which may impact the timing and value of enforcement, such as (a) a requirement for a public auction, or (b) regulatory consents?

Yes, timing of the enforcement may be affected in the event that there is a public auction of the assets or in the event that such auctions are not successful, if, for instance, no offers higher than the reserve amount are received.

Regulatory consents may also impose a significant delay in the conclusion of the enforcement in the event that the sale of the enforced assets to the acquirer is subject to obtaining regulatory consents, in the context of competition laws or sectorial regulation (sale of qualified shareholdings in financial institutions, defence industries, and public services concessionaires).

7.5 Do restrictions apply to foreign lenders in the event of (a) filing suit against a company in your jurisdiction, or (b) foreclosure on collateral security?

No, in principle, no such restrictions will apply.

7.6 Do the bankruptcy, reorganisation or similar laws in your jurisdiction provide for any kind of moratorium on enforcement of lender claims? If so, does the moratorium apply to the enforcement of collateral security?

Yes, in accordance with the Portuguese Insolvency Code, the commencement of an insolvency proceeding or a *procedimento de revitalização* (similar to a Chapter 11 procedure) will imply a moratorium on the enforcement of collateral security against the insolvent or quasi-insolvent borrower or guarantor.

7.7 Will the courts in your jurisdiction recognise and enforce an arbitral award given against the company without re-examination of the merits?

The Portuguese Republic is a party to the New York Arbitration Convention and therefore any arbitral awards given in another contracting state will be recognised without re-examination of the merits of the claim.

In relation to arbitral awards given in a state which is not a party to the New York Arbitration Convention, or any other convention to which the Portuguese state is a party, the enforcement of an arbitral ward in Portugal is subject to the recognition of such award by a court of competent jurisdiction in Portugal, irrespective of the nationality of the parties.

8 Bankruptcy Proceedings

8.1 How does a bankruptcy proceeding in respect of a company affect the ability of a lender to enforce its rights as a secured party over the collateral security?

Yes, in accordance with the Portuguese Insolvency Code, the commencement of an insolvency proceeding or a *procedimento de revitalização* (similar to a Chapter 11 procedure) will suspend all enforcement proceedings against the company.

8.2 Are there any preference periods, clawback rights or other preferential creditors' rights (e.g., tax debts, employees' claims) with respect to the security?

Under the Portuguese Insolvency Code, there is a two-year suspect period, during which any acts that are "prejudicial" to the insolvent entity and are carried out in bad faith will be set aside.

In addition, the Portuguese Insolvency Code sets out the specific situations in which certain acts may be set aside, including, *inter alia*:

(i) any acts carried out within two years prior to the commencement of the insolvency proceedings without there having been consideration thereof;

(ii) the provision of security for existing obligations by the insolvent entity within six months prior to the commencement of the insolvency proceedings;

(iii) the provision of guarantees by the insolvent entity in respect of debts of third parties within six months prior to the commencement of the insolvency proceedings where there is no benefit (vested interest) to the insolvent entity; or

(iv) the provision of security by the insolvent entity in respect of new transactions within 60 days prior to the commencement of the insolvency proceedings.

Under the Portuguese Civil Code, there is also a concept of *impugnação pauliana* pursuant to which an action could be brought by a creditor to set aside a transaction that results in the decrease of the bankrupt company assets and in circumstances in which there was no consideration given certain requirements are met.

Preferential creditor's rights exist under Portuguese law such as court fees, tax debts and employees claims.

8.3 Are there any entities that are excluded from bankruptcy proceedings and, if so, what is the applicable legislation?

Yes, the Portuguese Republic and certain public sector entities are excluded from Portuguese insolvency laws and there is no applicable legislation governing the insolvency of such entities.

8.4 Are there any processes other than court proceedings that are available to a creditor to seize the assets of a company in an enforcement?

In accordance with (i) the Portuguese Civil Code, (ii) the Portuguese Commercial Code, (iii) the regime of the financial pledge, or (iv) the regime of the banking pledge, it is possible that the enforcement of a pledge is conducted in an out-of-court proceeding.

In the case of a pledge created under the rules of the Portuguese Civil Code, the parties may agree to an out-of-court sale of the pledged assets. Please note, however, that in this situation, the pledged assets will, in principle, be in the possession of the pledgee or a custodian appointed by the parties.

In the case of a financial pledge, the Commercial Code pledge, or a banking pledge, the assets may not be in the possession of the pledgee. If the assets are in the possession of the pledgee or an agent appointed by the pledgee, the pledgee may appropriate the assets, but must return to the pledgor any excess amounts.

9 Jurisdiction and Waiver of Immunity

9.1 Is a party's submission to a foreign jurisdiction legally binding and enforceable under the laws of your jurisdiction?

Yes, please see the answer to question 7.2 above.

9.2 Is a party's waiver of sovereign immunity legally binding and enforceable under the laws of your jurisdiction?

In the event that an entity benefits from sovereign immunity, the waiver of the benefit of such immunity will be valid. However, it should be noted that the assets of such entity which are of the public domain (*domínio público*) or used for the purpose of pursuing a public service may not be seized and the entity may not waive immunity over such assets, unless there is a specific law approved for such purpose.

10 Licensing

10.1 What are the licensing and other eligibility requirements in your jurisdiction for lenders to a company in your jurisdiction, if any? Are these licensing and eligibility requirements different for a "foreign" lender (i.e. a lender that is not located in your jurisdiction)? In connection with any such requirements, is a distinction made under the laws of your jurisdiction between a lender that is a bank *versus* a lender that is a non-bank? If there are such requirements in your jurisdiction, what are the consequences for a lender that has not satisfied such requirements but has nonetheless made a loan to a company in your jurisdiction? What are the licensing and other eligibility requirements in your jurisdiction for an agent under a syndicated facility for lenders to a company in your jurisdiction?

Under the General Framework of Credit Institutions and Financial Companies (as approved by Decree-Law No. 298/92 of 31 December), only licensed entities may carry out lending activity in Portugal on a professional basis. The provision of loans to Portuguese entities on a professional and regular basis will trigger a licensing requirement in Portugal. However, if a foreign entity provides loans to Portuguese entities on a single or very infrequent basis no licensing requirement will apply as the foreign lender may be deemed not to be carrying out activity in Portugal, which assumes a repetition of acts or transactions in Portugal.

EEA entities benefit from passporting rights under the Capital Requirements Directive.

So far as the agent is concerned, no specific licensing requirement applies, although if the agent is a licensed entity in, or passported into, Portugal, then this will mitigate the risk of triggering a licensing requirement in Portugal for the lenders.

11 Other Matters

11.1 Are there any other material considerations which should be taken into account by lenders when participating in financings in your jurisdiction?

We believe that questions above fairly address the main material issues that arise generally in the context of lending transactions.

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Gonçalo dos Reis Martins has gained a comprehensive experience over the last 15 years in advising leading international and domestic investment and retail banks, other financial institutions and asset managers in a wide range of transactions, including syndicated loans for Portuguese blue chip corporates, asset finance transactions for the oil industry, project finance, direct lending, multi-jurisdictional supply chain finance transactions and Islamic finance work. He has also been involved in the development of the contractual framework in offering by banks of new technology-based products for retail clients as well as in the engagement of Portuguese banks by Fintech companies.

Before joining PLMJ he worked in another leading Portuguese law firm and a valuable international experience, having been seconded to the Capital Markets department of Simmons & Simmons and Morgan Stanley's Legal Department (Fixed Income Division), both in London.

Gonçalo earned his Law degree from the Law School of Universidade Nova de Lisboa in 2002, where he also lectured. He is also entitled to practise under English law, being a member of the Law Society of England and Wales since 2007.

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The PLMJ Finance team is comprised of four partners, 12 associates and three trainees.

Romania

Valentin Trofin

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1 Overview

1.1 What are the main trends/significant developments in the lending markets in your jurisdiction?

In 2018, property investment volume in Romania is estimated at *ca*. €900 million, a value slightly below that registered in 2017 (€963 million). However, several transactions in different stages of negotiations were postponed and they will most likely be concluded during the first half of 2019.

The overall number of transactions decreased, although the average deal size increased, standing at approximately €31 million. Bucharest accounted for over 78% of the total investment volume. Market volumes were dominated by office transactions (50%), while retail accounted for 35% of the total.

2018 ended with a significant premiere on the local real estate market: Romanian investors ranked second in generated volumes by nationality. Almost €200 million was spent buying commercial properties (about a quarter of the total volume), a significant leap of more than five times the volume in 2017, according to Colliers International.

1.2 What are some significant lending transactions that have taken place in your jurisdiction in recent years?

Total financing under the European Fund for Strategic Investments (EFSI) in Romania amounts to €652 million and is set to trigger €2.7 billion in additional investments. For infrastructure and innovation projects, there were 15 approved projects financed by the European Investment Bank (EIB) with EFSI backing and the approximately €536 million of total financing is set to trigger €1.399 million in investments. For small and medium companies, there were 13 approved agreements with intermediary banks or funds financed by the European Investment Fund (EIF) with EFSI backing and the €115 million of total financing is set to trigger approximately €1.3 billion in investments, with some 15,819 SMEs and mid-cap companies expected to benefit from improved access to finance.

Other sources for financing in Romania include syndicated loans. The Romanian syndicated loan market is estimated at €1 billion. For example, in March 2018, BERD and ING Bank provided to CTP a syndicated loan with a value of EUR 96 million.

2 Guarantees

2.1 Can a company guarantee borrowings of one or more other members of its corporate group (see below for questions relating to fraudulent transfer/financial assistance)?

A company may guarantee the borrowings of other members of its group if the guarantor has a certain commercial benefit deriving from the guarantee.

The most important restriction provided by Romanian law on this matter is that the guaranteeing operation should not represent a financial assistance transaction.

The assessment of the commercial benefit is not subject to any particular criteria. Thus, the guarantor's directors shall carefully assess each case, considering the ratio between risks undertaken and the potential benefits that might be obtained by the guarantor, and also the general financial situation of the borrower, the general and specific terms of transaction and the group relationship.

2.2 Are there enforceability or other concerns (such as director liability) if only a disproportionately small (or no) benefit to the guaranteeing/securing company can be shown?

According to Romanian law, financial assistance is prohibited. This interdiction is stipulated specifically only for the joint stock companies, but there are opinions arguing that it should also be applied to limited liability companies.

Secondly, as shown at question 2.1, a guarantor should have a certain interest in relation to any guarantee granted to support borrowings of another corporation. The apparent lack of counter-performance when a company guarantees the loan taken by an affiliate is not automatically equivalent to an act of no social interest.

Also, the Romanian Company Law provides that joint stock companies cannot guarantee the borrowings of its directors and the borrowings of companies where directors or their spouses or relatives are directors or shareholders with more than 20% of the share capital.

If one of these rules are breached, the guarantee will be declared null and void and can attract criminal liability of the directors in specific cases.

Another requirement set by the law for the guarantor is to possess and maintain sufficient assets in order to cover the secured liabilities, except where the creditor requires that the guarantor be a particular person.

2.3 Is lack of corporate power an issue?

In order to be able to grant loans, a company must have lending activities included in its scope of activity, and be appropriately authorised to perform such activities.

In the case of affiliated companies, in order not to fall within the scope of normative acts applicable in the field of financial-banking activities issued by the National Bank of Romania, the borrowing company will have to prove the necessity, the opportunity and the efficiency of such a lending operation (that is, when the loan is granted between the members of a company group).

2.4 Are any governmental or other consents or filings, or other formalities (such as shareholder approval), required?

Usually, there is no need for such consents. Still, in the case of joint stock companies, the board of directors or the directorate will be able to conclude legal acts in the name of and on behalf of the company to establish security interests over the company's assets whose value exceeds half of the book value of all the company's assets at the date of conclusion of the legal act, though only with the prior approval of the general meeting of shareholders.

In addition, when making any payments equal to or greater than EUR 50,000 or equivalent to non-residents, residents of credit institutions have the obligation to fill in a form provided by the credit institution used for the payment or by the payment authority. Also, credit institutions may use forms according to their own requirements in order to make any payments to non-residents with a value of less than EUR 50,000 or equivalent at the date of payment.

2.5 Are net worth, solvency or similar limitations imposed on the amount of a guarantee?

In general, no (except for the approvals for the guarantees referred to in question 2.4).

2.6 Are there any exchange control or similar obstacles to enforcement of a guarantee?

Usually, there are no obstacles to enforcement of a guarantee. Yet, in case of foreign lenders, the borrower can be restricted or limited from paying due amounts and the lender can be restricted from exercising its rights against a borrower. This safeguard measures may be imposed by the National Bank of Romania according to the regulation on the foreign exchange regime.

3 Collateral Security

3.1 What types of collateral are available to secure lending obligations?

The Civil Code provides the following types of collaterals available in order to secure lending: pledge and immovable mortgage.

3.2 Is it possible to give asset security by means of a general security agreement or is an agreement required in relation to each type of asset? Briefly, what is the procedure?

An agreement in relation to each type of asset is not required, only a distinction between movable and immovable property and shares.

Firstly, a general pledge agreement may be concluded that covers most types of asset, such as bank accounts, stocks, inventory, receivables, intellectual property, intangible assets and universalities, or it can be divided into many agreements for each type of asset.

Secondly, in order to take a collateral security over the real estate of the borrower, an immovable mortgage agreement is usually used, which may include the rent and insurance pertaining to the real estate.

Thirdly, the share mortgage agreement is used when the lending transaction is secured by the shareholders of the borrower company with their own shares.

3.3 Can collateral security be taken over real property (land), plant, machinery and equipment? Briefly, what is the procedure?

Collateral security can be taken over land, plant, machinery and equipment.

In cases regarding land, an immovable mortgage agreement will be concluded. The agreement will be authenticated by a public notary and registered in the Land Book. If there are some movable assets as accessories to the real estate, the agreement will also be registered in the Electronic Archive.

Plant, machinery and equipment are usually brought as security by means of a pledge agreement. This does not require authentication by a public notary, only a deed that describes the assets with sufficient precision. A description is sufficiently precise, even if the asset is not individualised, insofar as it reasonably allows it to be identified.

3.4 Can collateral security be taken over receivables? Briefly, what is the procedure? Are debtors required to be notified of the security?

According to Romanian law, collateral security can be taken over receivables by way of pledge. The mortgage may have as its object either one or more receivable or a universality of receivables.

The debtor of the pledged debt must be notified in writing, with the notification coming into effect as of the date on which the debtor received the communication. On the other hand, the effects of the notification are not conditional on the debtor's effective receipt of the notification; according to the law, the pledge lender is only obliged to inform the debtor about establishing the mortgage.

A pledge on a receivable that is also guaranteed with a movable or immovable mortgage must be registered with the Electronic Archive or the Land Book.

A pledge of a receivable confers upon the creditor, when the conditions for the commencement of forced execution are met, the right to take over the title of the claim, to demand and obtain the payment or, at his choice, to sell the claim and to take the price, all within the guaranteed amount.

3.5 Can collateral security be taken over cash deposited in bank accounts? Briefly, what is the procedure?

According to Romanian law, collateral security can be taken over cash deposits in bank accounts. In this case, the bank account must be individually identified in the mortgage agreement.

The publicity of the mortgage on the bank accounts opened at a credit institution is made by registering the mortgage in the archive or can be satisfied by checking the account.

In order to ensure priority, the lender should hold control over the mortgaged bank account.

A creditor acquires control over an account if (i) the mortgage lender is the actual credit institution where the account is opened, (ii) the creator, credit institution and creditor agree in writing that the credit institution, without requiring the consent of the mortgage constituent, will follow the instructions by which the creditor owns the amount in the account, or (iii) the mortgage creditor becomes the account holder.

3.6 Can collateral security be taken over shares in companies incorporated in your jurisdiction? Are the shares in certificated form? Can such security validly be granted under a New York or English law governed document? Briefly, what is the procedure?

Collateral security may be taken over shares in companies incorporated in Romania, usually by means of a pledge.

A pledge of the shares shall be made by means of a private signature, showing the amount of the debt, the value and the category of the guaranteed shares, and in the case of registered or bearer nominatives issued in the material form, also by mentioning the pledge by title, signed by the creditor and the shareholder or their trustees.

The pledge shall be registered in the register of shareholders held by the board of directors, respectively by the directorate, or, as the case may be, by the independent company keeping the shareholder register. The pledge creditor will receive the proof of registration.

The pledge becomes opposed to third parties and acquires its rank in the order of preferred creditors as of the date of registration in the Electronic Archive of the Real Securities Guarantees.

Even if the legal basis of the constitution, transfer, restraint or extinction of the collateral security was constituted by the application of another law, the mortgage will be subject to the law of the place where the asset is situated. The validity, the publicity and the effects of the mortgage or pledge will be subject to Romanian law, it therefore being necessary to conclude one of the mortgage agreements shown above.

3.7 Can security be taken over inventory? Briefly, what is the procedure?

Under Romanian law, a general pledge agreement may be concluded over inventory. This agreement is not subject to the authentication of the public notary, but the assets must be described with sufficient precision. As mentioned above, a description is sufficiently precise, even if the asset is not individualised, insofar as it reasonably allows it to be identified.

The description can be made by drawing up a list of mortgaged movable assets, by determining the category to which they belong, by indicating the quantity, by setting a determination formula and by any other means that reasonably allows the identification of the mortgaged movable asset.

3.8 Can a company grant a security interest in order to secure its obligations (i) as a borrower under a credit facility, and (ii) as a guarantor of the obligations of other borrowers and/or guarantors of obligations under a credit facility (see below for questions relating to the giving of guarantees and financial assistance)?

There is no such prohibition according to Romanian law; therefore a company may grant a security interest in order to secure its obligations under a credit facility both as a borrower and as a guarantor of the obligations of other borrowers and/or guarantors of obligations.

3.9 What are the notarisation, registration, stamp duty and other fees (whether related to property value or otherwise) in relation to security over different types of assets?

As a general rule in the Romanian procedure related to granting security over different types of asset, there is no stamp duty or other similar fee.

The only fees payable are those associated with: the registration of mortgages in the Electronic Archive or other public register; the authentication of immovable mortgage agreements by a public notary and authorised translations of finance documents; and the registration of such an agreement in the Land Book.

3.10 Do the filing, notification or registration requirements in relation to security over different types of assets involve a significant amount of time or expense?

Generally, the notification and the registration of securities does not involve a significant amount of time. In order to register a deed or a court decision in the Land Registry, it usually takes a few days and in the Electronic Archive, a few minutes. The authentication of an immovable mortgage agreement by a public notary usually takes a few hours. The fees payable in order to register the security is calculated proportionally with the value of the guaranteed asset, but is not a costly procedure.

3.11 Are any regulatory or similar consents required with respect to the creation of security?

In order to create a security, the articles of association of the company should mention the approval levels for a facility or it can issue a board decision on the matter.

As mentioned above, for joint stock companies, if the security exceeds half of the book value of the company's assets at the date of conclusion of the legal act, the security may be granted only with the prior approval of the general meeting of shareholders.

3.12 If the borrowings to be secured are under a revolving credit facility, are there any special priority or other concerns?

In case of borrowings under a revolving credit facility, there is no special priority. The guarantee structure is flexible, including mortgage guarantees on equipment, machinery, and real estate.

3.13 Are there particular documentary or execution requirements (notarisation, execution under power of attorney, counterparts, deeds)?

See our answers above.

4 Financial Assistance

4.1 Are there prohibitions or restrictions on the ability of a company to guarantee and/or give security to support borrowings incurred to finance or refinance the direct or indirect acquisition of: (a) shares of the company; (b) shares of any company which directly or indirectly owns shares in the company; or (c) shares in a sister subsidiary?

(a) Shares of the company

According to Romanian law, a company is allowed to acquire its own shares, either directly or through a person acting in his own name but on behalf of the company concerned, subject to the following conditions:

(i) the approval of the acquisition of own shares is granted by an extraordinary general meeting of shareholders, which shall determine the conditions of the acquisition, in particular the maximum number of shares to be acquired, the duration of the authorisation (that it may not exceed 18 months from the date of publication of the decision in the Official Gazette of Romania, Part IV), and, in the case of an acquisition by onerous title, their minimum and maximum value;

(ii) the nominal value of own shares acquired by the company, including those already in its portfolio, may not exceed 10% of the subscribed share capital;

(iii) the transaction may only deal with fully paid shares; and

(iv) payment of the shares thus acquired shall be made only from the distributable profit or from the company's available reserves, entered in the last approved annual financial statement, except for the legal reserves.

If own shares are acquired for distribution to the employees of the company, the shares thus acquired must be distributed within 12 months from the acquisition date.

(b) Shares of any company which directly or indirectly owns shares in the company

The law provides that the subscription, acquisition or holding of shares in a joint-stock company by another company where the joint-stock company directly or indirectly holds the majority of the voting rights or whose decisions may be significantly influenced by the joint-stock company is considered to be carried out by the joint-stock company itself.

The provisions mentioned above shall also apply when the company through which the underwriting, acquisition or holding of such shares is performed is governed by the law of another state.

Moreover, a company may not make advances or loans or provide collateral security for the subscription or acquisition of its own shares by a third party. This provision shall not apply to transactions in current operations of credit institutions and other financial institutions.

Conclusion: in this situation, it is considered that the acquisition is carried out by the joint-stock company itself, thus the provisions under situation (a) are applicable; namely a company may not provide any financial assistance in the form of a loan, guarantee or security interest for the acquisition of its own shares as these ways of acquisition are not compliant with the four cumulative conditions provided above.

Moreover, providing loans or collateral security to a third party is expressly forbidden.

(c) Shares in a sister subsidiary

There is no financial assistance prohibition as such, but this type of transaction remains subject to the corporate benefit rules described above.

5 Syndicated Lending/Agency/Trustee/Transfers

5.1 Will your jurisdiction recognise the role of an agent or trustee and allow the agent or trustee (rather than each lender acting separately) to enforce the loan documentation and collateral security and to apply the proceeds from the collateral to the claims of all the lenders?

According to the provisions governing the mandate contract, the trustee can make conservation and administration acts (general mandate) and also disposition acts (special mandate – expressly empowered). Also, the mandate extends to all acts necessary for its execution, even if not expressly stated.

Moreover, according to the law, the administrators of a company are allowed to do all the operations required to carry out the object of the company's activity, except for the restrictions shown in the Articles of Incorporation.

The acts of disposition regarding the assets of a company may be concluded pursuant to the powers conferred to the legal representatives of the company, as the case may be, by law, by the Articles of Incorporation or by the decisions of the company's statutory bodies adopted in accordance with the provisions of the law and of the company's Articles of Incorporation. A special power of attorney in authentic form for this purpose is not necessary, even if the acts of disposition have to be concluded in authentic form.

The obligations and liability of administrators are governed by the provisions of the mandate contract and those specifically provided for by the law.

5.2 If an agent or trustee is not recognised in your jurisdiction, is an alternative mechanism available to achieve the effect referred to above which would allow one party to enforce claims on behalf of all the lenders so that individual lenders do not need to enforce their security separately?

See the answer to question 5.1 above.

5.3 Assume a loan is made to a company organised under the laws of your jurisdiction and guaranteed by a guarantor organised under the laws of your jurisdiction. If such loan is transferred by Lender A to Lender B, are there any special requirements necessary to make the loan and guarantee enforceable by Lender B?

In this particular case, the receivables assignment involves the transfer of one or more receivables from the primary creditor (acting as assignor) to a new creditor (acting as assignee) by means of a bipartite agreement, generally concluded between the creditors, while the assigned debtor is not even notified about this agreement. The consent of the debtor is required only when, as occasion requires, the debt is essentially linked to the person of the creditor.

The receivables assignment transfers to the assignee all the rights of the assignor relating to the assigned receivables and also the securities and all related accessories of the debt. However, the assignor cannot transfer to the assignee, without the consent of the pledger, the possession of the pledged asset to the assignee.

There are no special requirements necessary to make the loan and guarantee enforceable by the lender that took over the loan from the primary lender. However, the forms of publicity regarding the guarantees of the loans must be complied with.

6 Withholding, Stamp and Other Taxes; Notarial and Other Costs

6.1 Are there any requirements to deduct or withhold tax from (a) interest payable on loans made to domestic or foreign lenders, or (b) the proceeds of a claim under a guarantee or the proceeds of enforcing security?

The tax for the revenue in the form of interest paid by the borrower to a foreign lender is 16% and will be withheld by the borrower from the moment when the interest is paid. The abovementioned tax may be different where double tax treaty or EU regulation is applicable.

Where a lender is enforcing a security against a debtor (borrower or guarantor), he is not liable for any tax on proceeds of such a claim, except where the lender is a natural person.

As an exception, there are no requirements to deduct or withhold tax from interest payable on loans if both the borrower and the foreign lender are affiliated companies and the foreign lender has its headquarters in an EU country.

6.2 What tax incentives or other incentives are provided preferentially to foreign lenders? What taxes apply to foreign lenders with respect to their loans, mortgages or other security documents, either for the purposes of effectiveness or registration?

There are no tax incentives preferentially provided to foreign lenders.

With an immovable mortgage, the fee to be paid for its registration with the Land Book is composed of a fixed tax of RON 100 and a tax of 0.1% of the value of the secured receivable, according to Annex no. 1, point 2.3.3. of Order no. 16/2019 on the approval of tariffs for the service provided by the National Agency of Cadastre and Real Estate Advertising and its subordinated units and an authorisation fee for those who carry out specialised works of cadastre, geodesy and cartography.

With a movable mortgage, the charges for signing the credit agreement and the related guarantee in the National Registry for Security Interests are borne by customers.

Fees for guarantee notices were initially established by art. 27 of Law no. 297/2018. The amount of taxes is updated by Government decision, depending on the official rate of inflation.

Thus, at present, the fee charged for submitting a notice is RON 30.

6.3 Will any income of a foreign lender become taxable in your jurisdiction solely because of a loan to, or guarantee and/or grant of, security from a company in your jurisdiction?

A foreign lender in receipt of Romanian-source interest income would be liable to Romanian income tax, according to arts 222 and 223 (1) (b) of the Romanian Fiscal Code, except where double tax treaty or other EU regulations are applicable.

6.4 Will there be any other significant costs which would be incurred by foreign lenders in the grant of such loan/guarantee/security, such as notarial fees, etc.?

In addition to the cost of registration of the collateral security mentioned in question 6.2 above to create a valid mortgage over real estate, the agreement must also be notarised, and notary fees can be quite significant, varying depending on the value of the secured amounts and the mechanism used for establishing the security. Where the loan agreement is not considered under its applicable law as being an executory title, the enforcement of the mortgages over real estate may raise problems.

Lenders are not be subject to such costs, as, according to the practice of the Romanian market, these costs are borne by the borrower; nevertheless it is advisable that parties reach an agreement regarding the allocation of such costs.

6.5 Are there any adverse consequences for a company that is a borrower (such as under thin capitalisation principles) if some or all of the lenders are organised under the laws of a jurisdiction other than your own? Please disregard withholding tax concerns for purposes of this question.

No. However, on 1 January 2018, the applicable rules for deductibility of expenses were completely changed.

7 Judicial Enforcement

7.1 Will the courts in your jurisdiction recognise a governing law in a contract that is the law of another jurisdiction (a "foreign governing law")? Will courts in your jurisdiction enforce a contract that has a foreign governing law?

The Romanian Courts recognise the foreign law of a contract, but the internal legislation may raise some debate in connection with this issue. In accordance with the Romanian Civil Procedural Code, in a case which has an extraneity element, the court will apply the Romanian procedural regulation ("*forum regit processum*"), as a principle in accordance with art. 1088 of the Civil Procedural Code. Nowadays, the majority of foreign civil international legislation is built in accordance with this principle, without admitting any waiver.

However, the qualification of an issue as being governed by the procedural rules or by substantial rules will be made in accordance with the internal legislation, excepting the legal entities that have no correspondence with Romanian bodies. Thus, the quality of the parties, the object and the scope of the claim will be set in accordance with the law that governs the merits of the dispute. The evidence and the evidence power of the document will be made in accordance with the law applicable to the contract, whenever the law of the parties allows this.

In consequence, the parties may choose any substantial law in the agreement, but if they choose to commence legal proceedings in front of Romanian Courts, the Romanian procedural laws will be applied. In the latest situation, the substantial law of the agreement shall be used, excepting the aforementioned features.

Regarding a contract that has a foreign governing law, in accordance with EU Regulation no. 593/2008, on the law applicable to contractual obligations (Rome I), courts in Romania generally enforce such contracts, provided they have jurisdiction for claims under such contracts.

7.2 Will the courts in your jurisdiction recognise and enforce a judgment given against a company in New York courts or English courts (a "foreign judgment") without re-examination of the merits of the case?

In this case, a distinction between the English courts and the courts in the USA (namely, New York Courts) should be made. In accordance with EU Council Regulation no. 1215/2012, on jurisdiction and enforcement of judgments in civil and commercial matters ("Regulation Brussels I recast), a ruling rendered in an EU Member State shall be recognised without any special proceedings in any other EU Member States, unless the recognition is challenged.

However, in accordance with art. 45 of the aforementioned Regulation, on the application of any interested party, the recognition of a judgment may be refused, taking into consideration a few conditions stressed by this legal provision.

Regulation no. 1215 does not apply to judgments rendered by the NY Courts. In accordance with the Romanian Civil Procedural Code, foreign judgments are fully recognised in Romania (i) if they refer to the personal status of the citizens of the state where they were ruled, or (ii) if they were ruled in a third state first recognised in the state of citizenship of each party or, if recognition has been rendered on the basis of the law determined as applicable under the Romanian private international law, if they are not contrary to the public order of Romanian private international law and the right to defence has been fulfilled. Rulings other than those mentioned in the first paragraph may be recognised in Romania in order to benefit from "*res judicata*" (claim preclusion), if the following conditions are met cumulatively: (a) the judgment is final according to the law of the state where it was rendered; (b) the court which ruled it had, under the law of the state of residence, jurisdiction to hold the proceedings without, however, being based exclusively on the defendant's presence or property not directly related to the dispute in the state in which that court is situated; or (c) there is reciprocity regarding the effects of foreign judgments between Romania and the state of the court that ruled the judgment.

Also, if the judgment has been given in the absence of the party who has lost the case, it must also declare that the party concerned has been served in good time both with the summons for the substantive debate and with the referral of the court and that it was given the opportunity to defend itself and to appeal the decision.

Unless some prior conditions are met, the court will not rule on the merits of the foreign ruling and will not proceed on amending it.

7.3 Assuming a company is in payment default under a loan agreement or a guarantee agreement and has no legal defence to payment, approximately how long would it take for a foreign lender to (a) assuming the answer to question 7.1 is yes, file a suit against the company in a court in your jurisdiction, obtain a judgment, and enforce the judgment against the assets of the company, and (b) assuming the answer to question 7.2 is yes, enforce a foreign judgment in a court in your jurisdiction against the assets of the company?

Firstly, we should make a distinction depending on the enforceable character of the agreement under discussion. If the contract is governed by Romanian law and the enforceable character is recognised, a claim submission will not be necessary and the contract shall be enforced in accordance with the Romanian Civil Procedural Code (as it will be stressed below). If the contract is governed by foreign law, an application in court shall be necessary, in order to obtain a ruling and then enforce it.

A foreign company may submit an application to the Romanian Courts in order to obtain a favourable ruling against a debtor which is in payment default. This application may take six months to one year, depending on the circumstances of the case, considering that the debtor has no legal defence.

After the ruling becomes definitive and all the appeals are ruled, a foreign lender will follow the enforcement procedure in front of a bailiff. This procedure may also take three months to one year depending on the assets that are executed. Seizure of the bank accounts may solve the debt recovery earlier than the execution of a real estate or mobile goods (that require a more complex procedure).

For example, in case of real estate enforcement, the bailiff will organise a public auction in order to sell the asset and recover the enforced amounts. The creditor may choose to adjudicate the real estate on behalf of its receivable, if its economic reasons are in this respect.

Regarding mobile goods, depending on their specifications, their enforcement requires the presence of the Police authorities in accordance with art. 659 of the Romanian Civil Procedural Code. Also, the enforcement of such assets will be considered as being performed, only after the bailiff identifies the goods, which is rather difficult. The possession document gives the creditor the right over those assets.

We should stress that if the foreign lender holds a letter of guarantee (even issued by a foreign bank) against the Romanian debtor, this instrument shall be enforced immediately by the bank at the first demand of the creditor, in accordance with Paris Publication no. 758, related to the execution of such autonomous instruments. The only requirement in this respect is to indicate to the bank the contractual provision that was breached by the Romanian company.

7.4 With respect to enforcing collateral security, are there any significant restrictions which may impact the timing and value of enforcement, such as (a) a requirement for a public auction, or (b) regulatory consents?

Regarding the enforcement of collateral securities, as mentioned above, this stage requires a procedure in front of a bailiff. After the registration of the enforcement submission, the bailiff shall request court approval for initiating the enforcement procedure. This approval is provided by art. 666 of the Romanian Civil Procedural Code. After the court grants this approval (the approval is based on form condition verifications), the executor will start the enforcement procedure: identify the debtor's assets (that are located in the bailiff's territorial division); transmit seizure letters to all the banks; and try to identify if the debtor has mobile assets or real estate assets in the Land Book and with City Hall. Also, the bailiff may request Trade Registry information about the debtor's involvement in other companies, in order to seize these assets also.

As mentioned in question 7.3, the real estate execution requires the organisation of a public auction, in accordance with the provisions of art. 846 of the Romanian Civil Procedural Code. The real estate sale advertisement will be published at the bailiff's office, at the City Hall where the asset is located and also at the executing court. This advertisement is usually published in national newspapers, in order to ensure full advertisement of the auction.

7.5 Do restrictions apply to foreign lenders in the event of (a) filing suit against a company in your jurisdiction, or (b) foreclosure on collateral security?

There are no specific restrictions applying to foreign lenders in case of submitting a court application against a company or foreclosure on collateral security.

It should, however, be noted that foreigners who submit claims in Romania should set a procedural headquarter in Romania for the communication of procedural documents (usually the lawyer's office). If they do not comply with this legal requirement, the Romanian Courts will communicate the procedural documentation by post and the post receipt submission will be considered the evidence of a legal summoning procedure.

Also, all foreign documentation submitted before the Romanian courts will be translated into Romanian language by an authorised translator.

7.6 Do the bankruptcy, reorganisation or similar laws in your jurisdiction provide for any kind of moratorium on enforcement of lender claims? If so, does the moratorium apply to the enforcement of collateral security?

According to the Romanian legislation, from the date of the opening of the bankruptcy, reorganisation or similar proceedings, all judicial or extrajudicial claims against the insolvent/bankrupt debtor or any enforced execution proceedings are legally suspended. The main debt and all the penalties (contractual ones or legal interest) should be capitalised only by registering on the table of creditors. In this respect, the interested creditors may submit a registration petition to the judicial administrator/liquidator and in front of the insolvency court. This submission will show the amount of the receivable and its contractual and legal grounds. The judicial administrator/liquidator shall admit or dismiss the request of registration, depending on the grounds of the receivable. However, the creditor may challenge the liquidator/judicial administrator's decision in the insolvency court.

The Romanian Insolvency Law also stresses that no interest, increase or penalty, collectively called 'accessories', will be added to the receivables borne before the commencement of the insolvency procedure, except for guaranteed creditors (that hold a mortgage), which will be registered on the definitive table of creditors with the market value of the guarantee. This value will be set by a valuation report and in case the value resulting from the report is higher than the initial amount registered on the table, the favourable difference will be distributed to the guaranteed creditor. This means that the Romanian legislation gives to the guaranteed creditors additional rights other than those applicable to the rest of the creditors participating in the insolvency procedure, in order to add securities to their guaranteed receivable.

Also, in case no reorganisation plan is confirmed, all the penalties, legal interest and additional expenses borne after the initiation of the bankruptcy procedure will be paid in accordance with the contractual documentation and the payment chart of the reorganisation plan. In case the reorganisation plan fails, all the accessories will be owed by the debtor until the initiation of the insolvency procedure.

7.7 Will the courts in your jurisdiction recognise and enforce an arbitral award given against the company without re-examination of the merits?

According to art. 1125 of the Romanian Civil Procedure Code, a foreign arbitral award shall be enforced in Romania if the dispute is not contrary to the public policy of international private law. The procedure is provided by arts 1124–1134 of the Romanian Procedural Code.

At the same time, the Romanian Civil Procedure Code (art. 1065) stipulates the possibility of choosing the most favourable law ("*mitior lex*"): the New York Convention; or the Romanian Civil Procedure Code.

In other terms, the grounds for dismissing the recognition or the enforcement of the awards are identical in both normative acts because the Romanian Civil Procedure Code takes on the provisions of art. 5 of the New York Convention.

According to the Civil Procedure Code, in order to enforce foreign arbitral awards, an application for approval of the execution shall be submitted to the Tribunal, attached to the said award the arbitral convention translated in Romanian and over-certified by the Consulate. There is no requirement for a prior exequatur decision in order to address an application for declaration of enforceability. We should also stress that the aforementioned procedure is also called the exequatur procedure but this does not imply the involvement of a judicial executor (bailiff). This could have led to a confusion of terms.

Anyway, the Romanian Court shall only verify some prior procedural issues and will not argue the merits of the arbitral award.

8 Bankruptcy Proceedings

8.1 How does a bankruptcy proceeding in respect of a company affect the ability of a lender to enforce its rights as a secured party over the collateral security?

According to the Insolvency Law, from the opening date of the insolvency proceedings, all judicial, extrajudicial actions or enforcement measures for recovering any receivables against the debtor's assets are suspended.

The lenders can recover their claims, but only within the insolvency proceedings by submitting an application for receivables acceptance with the competent court and abiding by special rules provided under this procedure.

However, under the security held, the lender becomes a secured creditor and has certain preferential rights in the insolvency proceedings for the satisfaction of his claim.

8.2 Are there any preference periods, clawback rights or other preferential creditors' rights (e.g., tax debts, employees' claims) with respect to the security?

According to the insolvency law, certain claims have priority over a creditor's secured claim, in the following order:

- Taxes, stamps and any other fees incurred with respect to the sale of the respective secured asset.
- Receivables of utility services providers arising after the opening of the insolvency proceedings.
- Remuneration of the judicial administrator.
- Receivables of other secured creditors relating to the same secured asset if these arose during the insolvency proceedings.

Creditors granted with security over an asset have priority over that asset or the equivalent value of that asset, with the observance of the aforementioned limitations.

If, by selling the asset, the amounts do not cover the value of the debt, for the difference in the value, the creditors have an unsecured receivable that comes in competition with other receivables, in the following order:

- Fees, stamps or any other expenses related to the insolvency procedure.
- Claims resulting from financing granted during the insolvency proceeding.
- Labour-related claims.
- Claims arising from the debtor's activity after the opening of the insolvency proceedings.
- Fiscal claims.
- Receivables representing amounts owed by the debtor to third parties under alimony obligations.

- Receivables representing amounts established by the syndic-judge for supporting the debtor and their family, if the debtor is a natural person.
- Receivables representing banking loans, with accrued expenses and interest, resulting from product delivery, services or rents.
- Other unsecured claims.
- Subordinated claims, in the following order:
  - receivables of third parties that have acquired or sub-acquired in bad faith the debtor's goods, as well as the loans provided to the legal person debtor by a shareholder holding at least 10% of the share capital or voting rights in the general meeting of shareholders or by a member of the economic interest group; and
  - receivables resulting from gratuitous acts.

Where more creditors are granted the same security interest over the same asset, the priority is determined by reference to the moment the publicity formalities were performed (that is, registration with the Land Book or with the National Registry for Secured Transactions).

Therefore, on registration with the relevant public registry, the respective security interest ranks before the claims of any unsecured creditors and of the creditors holding subsequently registered security interests in respect of the same asset.

Where two or more creditors have the same priority rank, the sums are distributed proportionally by reference to the sum relating to the receivable of each such creditor.

8.3 Are there any entities that are excluded from bankruptcy proceedings and, if so, what is the applicable legislation?

According to the law, the insolvency procedure does not apply to public institutions, individuals, professionals who practise liberal professions (e.g. lawyers, doctors, architects, assistants, executors, experts, pharmacists) and to professionals who are subject to special provisions regarding their insolvency regime.

Also, the insolvency procedure is not applicable to the pre-university and university education units and institutions, as well as to the entities stipulated in art. 7 of the Government Ordinance no. 57/2002 on scientific research and technological development.

Persons performing liberal professions are liable civilly and disciplinarily for the damages caused in the exercise of their profession, according to special normative acts that regulate organisation and exercise of the respective profession.

Government Emergency Ordinance no. 46/2013 on the financial crisis and the insolvency of territorial-administrative units establishes the general framework and collective procedures for covering liabilities of the administrative-territorial units in the financial crisis or in insolvency.

Also, as of 1 January 2018, the Insolvency Law of Individuals (personal bankruptcy) entered into force.

8.4 Are there any processes other than court proceedings that are available to a creditor to seize the assets of a company in an enforcement?

In our legal system, the only creditors who can seize the assets of a company without court intervention are public institutions, the most common situation being the seizure performed by the Public Finance Administration for the recovery of tax liabilities owed by taxpayers to the state.

However, the Civil Code provides certain alternative enforcement measures for creditors, such as: (a) the possibility to temporarily take over mortgaged assets, for administration purposes, until the claims are satisfied; and (b) the possibility to appropriate the asset in order to extinguish the receivable, under certain conditions provided by the law.

Also, if the lender holds an enforcement title as defined by Romanian law (exchange bills, promissory notes, credit agreements under Romanian substantial law), it can easily be enforced, since the enforcement court intervention is purely a formal one, the court having the sole obligation to endorse forced execution in a non-contentious proceeding. After the writ of execution is given, the bailiff can take any and all the necessary measures for seizing the company's assets.

9 Jurisdiction and Waiver of Immunity

9.1 Is a party's submission to a foreign jurisdiction legally binding and enforceable under the laws of your jurisdiction?

In Romania, a contractual choice of forum is generally permissible and legally binding. Certain form requirements may apply. However, the choice of forum is not valid if it leads to the abusive deprivation of the protection provided by a Romanian court to one of the parties. Also, if other courts have exclusive jurisdiction, no choice of forum is permissible.

9.2 Is a party's waiver of sovereign immunity legally binding and enforceable under the laws of your jurisdiction?

A waiver of sovereign immunity from jurisdiction is generally legally binding, on the condition that the waiver is authorised by law or by international conventions to which Romania is a party. Also, the legal entities governed by public law having economic activities in their scope of activity are able to conclude arbitration agreements, unless the law or their act of incorporation provides otherwise.

10 Licensing

10.1 What are the licensing and other eligibility requirements in your jurisdiction for lenders to a company in your jurisdiction, if any? Are these licensing and eligibility requirements different for a "foreign" lender (i.e. a lender that is not located in your jurisdiction)? In connection with any such requirements, is a distinction made under the laws of your jurisdiction between a lender that is a bank *versus* a lender that is a non-bank? If there are such requirements in your jurisdiction, what are the consequences for a lender that has not satisfied such requirements but has nonetheless made a loan to a company in your jurisdiction? What are the licensing and other eligibility requirements in your jurisdiction for an agent under a syndicated facility for lenders to a company in your jurisdiction?

In Romania, a company could become a lender following the authorisation of its activity by the National Bank of Romania (NBR). An entity which carries out banking activities on a regular basis in Romania must either be duly licensed as a creditor institution or as a financing company, or non-banking financial institution.

Also, a company can grant loans to another company occasionally, but without doing it with professional title. In this case, the Romanian law provides that these companies are not subject to the legal provisions on credit institutions.

A creditor institution must have its own funds or a level of initial share capital that cannot be less than EUR 5 million. During the operation of the creditor company, the share capital must not fall below this level, otherwise the NBR may close its activity.

In order to obtain the approval, the applicants shall submit to the NBR a plan of activity, including the types of activity to be carried out and the organisational structure and showing the ability to achieve their objectives under a prudent and healthy banking practice.

Regarding the structure of the creditor, the company must have a rigorous management framework which includes processes to identify, manage, monitor and report the risks to which it is or might be exposed, adequate internal control mechanisms, including administrative and accounting procedures, rigorous policies and remuneration practices, which promote and agree with healthy and effective risk management.

The management of the creditor shall be provided by at least two people with good reputations and adequate banking experience.

The licensing and eligibility requirements for creditors in Romania are also applicable to credit institutions in other countries, with the following specifications:

(a) Credit institutions authorised and supervised by the competent authority of a Member State may be considered as creditors by the establishment of branches or by the provision of services directly, if those activities are covered by the authorisation granted by the competent authority of the country of origin.

(b) A credit institution from another Member State may carry out activities directly in Romania, pursuant to European Directive no. 2013/36/EU and European Regulation no. 575/2013, if authorised by the competent authority of the Member State.

(c) A credit institution authorised in a Member State may set up a branch in Romania or provide services directly on the basis of the notification sent to the National Bank of Romania by the competent authority of the country of origin.

(d) A credit institution in a third country can only operate in Romania by setting up a branch in Romania authorised by NBR. The initial capital of the branch may not be lower than the EUR 5 million.

In Romania, both non-banking financial institutions (NFI) and banks are regulated. The main differences are as follows:

(a) NFI may grant credits but cannot attract deposits. This last activity can only be done by credit institutions.

(b) NFIs are divided into two categories: NFIs registered in the Special Register of the National Bank; and those entered only in the General Register. In order to be part of the first category, non-bank financial institutions must meet certain capital criteria, the amount of credits granted, and total assets requirements.

(c) In order to receive an authorisation from the NBR, a bank must prove that it has an initial minimum capital of EUR 5 million.

(d) A non-bank financial institution shall have a share capital of only EUR 200,000, or EUR 3 million in the case of NFIs granting mortgages.

Non-compliance with such banking rules may lead to the criminal liability. According to the Romanian law, it constitutes an offence and it is punishable by imprisonment from one to five years.

Romanian legislation does not contain provisions on syndicated facilities. Although in practice there are situations in which syndicated loans are used by companies, the Romanian legislation does not contain provisions on this type of institution. Usually such contracts are drafted in English and governed by UK law, with the mention that where applicable, Romanian legislation prevails.

11 Other Matters

11.1 Are there any other material considerations which should be taken into account by lenders when participating in financings in your jurisdiction?

Yes, there are other material considerations which should be taken into account by lenders when they are participating in financings, which includes the establishment of personal insolvency for Romanian individuals.

The Personal Insolvency Law was inspired by the legislation applicable to the insolvency of natural persons in EU and aims to offer Romanian citizens similar rights (and obligations) as the majority of EU Member States recognise when their EU citizens declare insolvency.

The Personal Insolvency Law creates the legal framework for insolvency of individuals, i.e. a procedure of declaring insolvency of individuals aimed at offering possibilities to natural persons to (partially) clean their debts, under certain conditions set out by the Personal Insolvency Law. There are three different insolvency procedures, applicable depending on the particular situation of the individual:

- the insolvency procedure based on a debt repayment plan (upon request of the individual);
- the insolvency procedure based on asset liquidation (either at the request of the individual or of his/her creditors); and
- the simplified insolvency procedure (applicable to individuals who lost over 50 per cent of their work capacity or qualify for standard retirement).

The relevant bodies that will apply the insolvency procedure to individuals are the insolvency commission (a new administrative body which will be established for the purposes of the personal insolvency of individuals), the insolvency administrator or liquidator and the courts.

While the banking industry is generally fine with the compromise solution enacted under the Personal Insolvency Law, it is yet to be seen to what extent individuals will try to abuse the newly introduced benefits.

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Valentin Trofin holds a Bachelor of Laws Degree (1998) and a Master's Degree in International Commercial Arbitration (2014), both from the Law School of the University of Bucharest. He also holds a Diploma in International Commercial Arbitration from the Chartered Institute of Arbitrators (2014). Valentin Trofin is a Ph.D. candidate at the Doctoral Law School of Titu Maiorescu University.

Valentin Trofin was admitted to the Bucharest Bar Association (1999), the National Association of Authorized Romanian Valuers (2003) and to the Romanian National Union of Insolvency Practitioners (2010). He was admitted to the Fellowship of Chartered Institute of Arbitrators, being a member of the European Branch's Executive Committee. Also, he is a member of the International Bar Association, the Society of Construction Law (UK), the Romanian Society of Construction Law and is a founding member and Treasurer of the Bucharest Arbitration Network.

Valentin Trofin is recognised as a leading practitioner in the construction industry and for real estate development, mergers & acquisitions and international arbitration. Valentin Trofin's multidisciplinary qualification as a lawyer, real estate appraiser and business appraiser helps him gain a quicker and better business understanding and allows him to render innovative solutions in each case.

Valentin Trofin's business sense, passion for technicalities and details and great negotiation skills makes him the "most needed person" for all complex cases. When he is assigned to draft a bespoke agreement, his outstanding drafting skills enable him to deliver a well-structured agreement with a combination of plain and minimum legal language, resulting in an easy to understand agreement smartly dealing with all the risks involved. These skills, combined with his business understanding, are long-tested and, in every case, the results were the same: none of the disputes in which he has been involved have been referred to courts for resolution.

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Her area of expertise includes an extended range of fields: civil disputes, commercial cases, enforcement, bankruptcy proceedings and insurance legal matters.

She has also been involved in drafting and negotiating commercial contracts, finance documents and corresponding security packages as well as due diligence analyses in this respect.

Since being part of our team, Mihaela has provided general assistance in financial transactions, including financing in bilateral and syndicated loans, refinancing and loan restructuring, which she handled successfully.

TROFIN & ASOCIAȚII
BRAINMADE LEGAL SOLUTIONS

Trofin & Asociatii was founded in March 2003 as a boutique law firm specialised in the construction industry and corporate law. Immediately after that, in 2004 the firm become well known for its professionalism and leading voice in construction projects and real estate development. Since then, the firm's practice has widened, and it is now experienced in mergers and acquisitions, intellectual property, employment law, real estate development, insurance claims, banking & finance, public procurement, international commercial or investment arbitration and domestic litigation.

Since 2003, Trofin & Associates has been involved in more than 50 construction or real estate development projects with values ranging from EUR 10 million to EUR 70 million.

Since 2007, the firm has been involved in many cross-border transactions, especially in Turkey, the Russian Federation, North Africa and the Republic of Moldova. The firm has great experience in dispute resolution including international commercial arbitration, having been involved in more than 30 cases of domestic or international arbitration.

Every year, the firm's dispute resolution practice is involved, on average, in representing clients in more than 70 litigation and arbitration cases, with a peak in 2009–2012 when it was involved in more than 200 litigation and arbitration cases each year.

In 2016, the Romanian Government appointed the firm, as co-counsel, to represent Romania in an investment arbitration for a dispute involving hundreds of millions of euros under the rules of ICSID Washington D.C. (USA).

The lawyers in our firm have a strong academic background, being frequent speakers at workshops and international conferences.

Russia

Grigory Marinichev

Morgan, Lewis & Bockius LLP

Alexey Chertov

1 Overview

1.1 What are the main trends/significant developments in the lending markets in your jurisdiction?

The Russian lending market has been under mounting pressure from US sanctions during 2018. The major deals involving state-owned banks and companies that occurred are non-public and are denominated in Russian rubles, euros or, sometimes, in other currencies.

The prepayment finance market has further increased its share and, in terms of amount and volume of transactions, has significantly surpassed the market of "traditional" pre-export finance and other "classical" trade finance structures. There have been a number of large prepayment finance deals involving major producers of oil, copper, coal, aluminum, gas, gold and other commodities which demonstrate the recent market trend of prepayment structures expanding well beyond the oil market.

There is a new trend to structure cross-border gold prepayment through a direct gold supply arrangement between an international bank and a Russian producer, though traditionally such deals have been structured through licensed Russian banks.

An increasing number of lending transactions are governed by Russian law. Federal Law No. 486-FZ, dated 31 December 2017, "On syndicate facility (loan) and on amendments to certain legislative acts of the Russian Federation" (the "**Syndication Law**") contains detailed regulations of syndication lending and the role of lenders, facility agents and arrangers. Some Russian state banks tend to structure Russian law syndicated lending in accordance with the Syndication Law.

In 2018, the currency control requirements were softened, e.g., the obligation to open a transaction passport for a cross-border lending deal has been abandoned.

1.2 What are some significant lending transactions that have taken place in your jurisdiction in recent years?

Significant public finance transactions in 2018 include, among others:

- a USD 1,055 billion five-year pre-export financing of SUEK arranged by a group of 18 international and domestic lenders;
- a USD 825 million pre-export financing of Uralkali;
- a USD 820 million three-year financing of EuroChem Group AG organised by a syndicate of banks including UniCredit Bank AG, London Branch, as the facility agent;
- a USD 570 million syndicated pre-export financing of Siberian Anthracite with ING Bank, Banca Intesa, Credit Suisse and Sberbank of Russia as the mandated lead arrangers;
- a USD 300 million syndicated loan to refinance Eurobonds for Nordgold arranged by ING, Raiffeisenbank, Raiffeisenbank Bank International, Rosbank, Societe Generale and Unicredit;
- a USD 250 million syndicated pre-export finance of Russian Copper Company provided by more than 10 banks with Natixis as the co-ordinating mandated lead arranger; and
- a USD 100 million refined gold prepayment for GV Gold arranged by Societe Generale.

2 Guarantees

2.1 Can a company guarantee borrowings of one or more other members of its corporate group (see below for questions relating to fraudulent transfer/financial assistance)?

Generally, there are no restrictions on provision of guarantees or sureties by a Russian company in favour of members of its group. If a guarantee or surety constitutes a "major" or "interested party" transaction, it may be subject to certain corporate consents, approvals or notification requirements.

2.2 Are there enforceability or other concerns (such as director liability) if only a disproportionately small (or no) benefit to the guaranteeing/securing company can be shown?

Any transaction, including a guarantee or surety, may be challenged by the company and, in certain cases, by its shareholders or members of the board if such transaction is entered into to the detriment of the company and the counterparty was aware of such circumstances.

Also, a director of a Russian company shall generally act reasonably and in good faith and in the best interest of the company. If such obligations are breached, the directors may be sued for losses caused to the company.

In case of insolvency of a company, a guarantee or surety may be challenged if such transaction is aimed at a violation of creditors' rights or constitutes a preferential transaction. Directors and controlling persons of a company may be subject to "subsidiary (secondary) liability" if the insolvency occurred as a result of their actions.

2.3 Is lack of corporate power an issue?

Subject to certain exceptions, Russian companies can enter into any lawful transactions. However, the powers of a CEO may be limited by the company's articles of association. The articles of association may also contemplate that two CEOs shall act jointly or severally (in the latter case, the powers may be divided between them). In certain cases, a guarantee or surety may require consent of (notification to) the shareholders (participants) or the board of directors if it constitutes a "major" (i.e., a transaction amounting to 25% or more of the company's assets) or an "interested party" transaction.

2.4 Are any governmental or other consents or filings, or other formalities (such as shareholder approval), required?

Generally, no governmental consents or filings are required in respect of guarantees or sureties. As described in question 2.3, a guarantee or surety may require consent of the shareholders (participants) or the board of directors if it constitutes a "major" or "interested party" transaction for the company and in other cases stipulated by the company's charter.

2.5 Are net worth, solvency or similar limitations imposed on the amount of a guarantee?

Generally, there are no such limitations. However, if the value of the transaction exceeds certain thresholds (such as 25% of the company's assets), this may be taken into consideration if the company's transaction is contested in the course of the company's insolvency.

2.6 Are there any exchange control or similar obstacles to enforcement of a guarantee?

There are generally no such obstacles other than insolvency of a company. In order for a company to make certain payments to a foreign lender in a foreign currency under the guarantee or surety, the company may be required to file with a Russian authorised bank certain documents (including the relevant guarantee or surety) in order to record the agreement for currency control purposes. Such filing is required to be made as a condition to a payment transfer rather than to the entry into the underlying transaction and such requirement is of an administrative nature and does not restrict or affect the company's obligation to make payments under the guarantee or surety.

3 Collateral Security

3.1 What types of collateral are available to secure lending obligations?

Russian law allows using various types of collateral including pledge of immovable property (mortgage), pledge of equipment, pledge of rights under bank accounts, pledge of goods in turnover, pledge over shares and participatory interest and pledge over receivables.

3.2 Is it possible to give asset security by means of a general security agreement or is an agreement required in relation to each type of asset? Briefly, what is the procedure?

Russian law generally allows extending the pledge to "all assets" of the company. The respective pledge agreement shall be made in written form. However, it is unlikely that a pledge created by such a pledge agreement would automatically extend to certain types of assets such as rights under bank accounts, immovable assets (mortgage), participatory interests in limited liability companies or shares in joint stock companies, since pledges over such assets are subject to registration/notarisation or other specific formalities.

3.3 Can collateral security be taken over real property (land), plant, machinery and equipment? Briefly, what is the procedure?

Security over immovable property (land, buildings, etc.) can be taken by way of mortgage. The mortgage agreement shall be made in written form. The mortgage shall be registered with the Unified State Register of Immovable Property ("*Единый государственный реестр недвижимости*"). Security over machinery and equipment is usually taken by entering into a pledge of movables. The pledge of machinery and equipment can be recorded with the register of notices on pledges maintained by the notaries. Such notification is not mandatory and is not required for a pledge to be effective. However, the notification makes the pledge public and third parties are deemed notified about such pledge. This is particularly important in case of a dispute in respect of the priority of pledges created over the same property.

3.4 Can collateral security be taken over receivables? Briefly, what is the procedure? Are debtors required to be notified of the security?

Yes, security over receivables is usually taken by way of a pledge. The debtor shall be notified about the pledge of receivables. Consent of the debtor is generally not required unless otherwise provided by the underlying contract. The pledge over receivables can be recorded with the register of notices on pledges maintained by the notaries (for more information, please refer to question 3.9).

3.5 Can collateral security be taken over cash deposited in bank accounts? Briefly, what is the procedure?

Security over cash deposited in bank accounts is usually taken by way of a pledge of rights under bank accounts. The Russian Supreme Court has supported a view that a pledge of rights under a bank account is possible only in respect of specific pledge accounts ("*залоговые счета*"), which means that there is substantial risk that a pledge of rights in respect of an ordinary bank account may be unenforceable. It is impossible to bypass this rule by changing the status of an ordinary bank account to the specific pledge accounts. A new pledge account must be opened for this purpose. A pledge of rights under a bank account is created from the moment when the respective account bank is notified about the pledge. However, if the account bank is the pledgee, the pledge will be created from the date of the pledge agreement.

3.6 Can collateral security be taken over shares in companies incorporated in your jurisdiction? Are the shares in certificated form? Can such security validly be granted under a New York or English law governed document? Briefly, what is the procedure?

Russian law makes a distinction between shares in joint stock companies and participatory interests in limited liability companies. Both can serve as collateral and both are in a non-documentary form.

In respect of the participatory interests, a pledgor must obtain the prior consent of a majority of participants in the limited liability company if the pledge is made in favour of a third party. A participatory interest pledge agreement must be made in written form and notarised. A pledge of participatory interest is deemed to be created from the moment of its registration in the Unified State Register of Legal Entities.

In contrast with a participation interest pledge, notarisation of a share pledge is possible but not mandatory. No consent of other shareholders is required. A share pledge must be registered with the shareholders' register or a depositary.

Pledges of participatory interests and shares are usually governed by Russian law. New York and English law may also be used to govern local pledges, but these are rarely seen because enforcement of such pledges may be more complicated in practice.

3.7 Can security be taken over inventory? Briefly, what is the procedure?

Russian law recognises the pledge of inventory (pledge of goods in turnover). The subject matter of a pledge of goods in turnover can be determined by specifying the generic features of the goods and their location (e.g., goods in certain premises). The pledge over inventory can be recorded with the register of notices on pledges maintained by the notaries (for more information, please refer to question 3.9).

3.8 Can a company grant a security interest in order to secure its obligations (i) as a borrower under a credit facility, and (ii) as a guarantor of the obligations of other borrowers and/or guarantors of obligations under a credit facility (see below for questions relating to the giving of guarantees and financial assistance)?

Yes, both options are possible as long as the required corporate consents (if any) are obtained.

3.9 What are the notarisation, registration, stamp duty and other fees (whether related to property value or otherwise) in relation to security over different types of assets?

Any pledge agreement shall be made in written form. Notarisation of a pledge of participatory agreement is mandatory, while notarisation of pledges of other types of assets is possible but, as a rule, not mandatory. However, out-of-court enforcement of the pledged assets by way of notarial endorsement is only possible if the agreement is notarised.

A mortgage shall be registered with the Unified State Register of Immovable Property and takes effect from the date of such registration. Similarly, a pledge over participatory interest shall be registered with the Unified State Register of Legal Entities and takes effect from the date of such registration.

The amount of notary fees depends on the amount of the secured obligation and whether the notarisation is mandatory. If the notarisation is mandatory, the amount of the notary fee cannot exceed RUB 150,000. If the notarisation is not mandatory, this amount cannot exceed RUB 500,000.

Pledges of most assets (other than immovable property, shares, participatory interests, rights under bank accounts and pledges of other assets, transfers of rights in respect of which are subject to mandatory registration) can be recorded with the register of notices on pledges maintained by the notaries. Such notification is not mandatory and is not required for the validity of a pledge. However, the notification makes the pledge public and third persons are deemed notified about such pledge. This is particularly important in case of a dispute in respect of the priority of pledges. The fees in connection with registration of such notices are nominal (RUB 600 per notice).

The fees for registration of mortgage by legal entities in the Unified State Register of Immovable Property are RUB 4,000.

No stamp duties are payable as a matter of Russian law.

3.10 Do the filing, notification or registration requirements in relation to security over different types of assets involve a significant amount of time or expense?

The statutory term for registration of a mortgage is up to five business days, but in practice sometimes takes longer.

Notarisation of a participatory interest pledge and registration of the respective pledge in the Unified State Register of Legal Entities usually takes 7–15 days. Foreign pledgors and pledgees must collect and submit to the notary a set of notarised and apostilled corporate and other documents, which often takes some additional time.

Notices regarding pledges of movable property are submitted by the notaries and can be done within 1–2 hours.

Registration and notary fees are described in more detail in question 3.9.

3.11 Are any regulatory or similar consents required with respect to the creation of security?

Regulatory or similar consents are generally not required with respect to creation of security unless the rights of third parties are involved. In certain cases, corporate consents (notifications) may be required if the pledge agreement constitutes a "major" or "interested party" transaction.

Russian law does not make validity of a second or third ranking mortgage conditional on the consent of the first-ranking mortgagee. In practice, however, such consent is sometimes requested by the register.

3.12 If the borrowings to be secured are under a revolving credit facility, are there any special priority or other concerns?

Russian law previously required having a detailed description of the secured obligations, which created complications in instances when collateral secured the revolving facilities. At the moment, Russian law is far more flexible in respect of the requirement to describe the secured obligations, and expressly provides that the pledge may secure future obligations, so in our view the previous priority concerns in respect of a security relating to revolving facilities is less likely to be an issue.

3.13 Are there particular documentary or execution requirements (notarisation, execution under power of attorney, counterparts, deeds)?

Please refer to question 3.9 in respect of the pledge agreements/ mortgage agreements. Execution of contracts by means of electronic communication is allowed as long as such execution makes it possible to determine that the document has been signed by the relevant party.

Russian law does not set out any specific requirements in respect of execution of deeds.

4 Financial Assistance

4.1 Are there prohibitions or restrictions on the ability of a company to guarantee and/or give security to support borrowings incurred to finance or refinance the direct or indirect acquisition of: (a) shares of the company; (b) shares of any company which directly or indirectly owns shares in the company; or (c) shares in a sister subsidiary?

Financial assistance restrictions (including restrictions on the ability of a company to guarantee and/or give security to support borrowings incurred to finance or refinance the direct or indirect acquisition of shares of the company, shares of any company which directly or indirectly owns shares in the company or shares in a sister subsidiary) like the ones which exist in Germany and certain other jurisdictions do not exist in Russia. However, such guarantee or security may in certain cases require corporate consent. Please also refer to question 2.4 for further details.

5 Syndicated Lending/Agency/Trustee/ Transfers

5.1 Will your jurisdiction recognise the role of an agent or trustee and allow the agent or trustee (rather than each lender acting separately) to enforce the loan documentation and collateral security and to apply the proceeds from the collateral to the claims of all the lenders?

Russian law does not currently recognise the trustee relationship which is common in English law. However, the Russian Civil Code now contains provisions allowing creditors to enter into a pledge management agreement and appoint a "pledge manager" to act on behalf of several creditors in connection with the pledge. The pledge management agreement may contemplate payment of a fee to the pledge manager. The pledge manager shall act in the best interest of the creditors. The proceeds received by the pledge manager in connection with the pledge become the common property of the creditors unless the pledge management agreement provides otherwise.

The Syndication Law introduced the role of a facility agent referred to as the "facility manager". The functions of the facility manager can be carried out by a credit organisation, the state corporation Vnesheconombank, a foreign bank or an international finance organisation.

Facility managers shall run the register of the syndicate participants and record all amounts granted to the borrower. Facility managers shall act on behalf of lenders in their relationship with the borrower, mainly, collecting funds under facility, including interest amounts and other payments, and providing relevant documents and information to lenders and security arrangers.

5.2 If an agent or trustee is not recognised in your jurisdiction, is an alternative mechanism available to achieve the effect referred to above which would allow one party to enforce claims on behalf of all the lenders so that individual lenders do not need to enforce their security separately?

Please refer to the answer to question 5.1.

5.3 Assume a loan is made to a company organised under the laws of your jurisdiction and guaranteed by a guarantor organised under the laws of your jurisdiction. If such loan is transferred by Lender A to Lender B, are there any special requirements necessary to make the loan and guarantee enforceable by Lender B?

Rights under loan agreements and guarantees governed by Russian law are usually transferred by way of assignment. The consent of the debtor is not required unless otherwise provided by the loan agreement or guarantee. If the consent is required by the loan agreement or guarantee but is not obtained, the assignment would still be valid but the initial creditor would be liable for breach of contract.

6 Withholding, Stamp and Other Taxes; Notarial and Other Costs

6.1 Are there any requirements to deduct or withhold tax from (a) interest payable on loans made to domestic or foreign lenders, or (b) the proceeds of a claim under a guarantee or the proceeds of enforcing security?

Interest payable on loans made by Russian lenders (lenders incorporated in Russia and foreign lenders which have permanent establishment in Russia) is generally subject to Russian income tax at a rate of 20%. The same rate applies to a foreign lender receiving their income from interest on loans at a source in Russia. In this case, taxable income is withheld by the borrower.

Proceeds under a guarantee are subject to the same rules as taxable income under loan agreements.

6.2 What tax incentives or other incentives are provided preferentially to foreign lenders? What taxes apply to foreign lenders with respect to their loans, mortgages or other security documents, either for the purposes of effectiveness or registration?

The general approach under Russian law is that foreign lenders are subject to the same rules as Russian lenders. However, international tax treaties provide certain specific tax exemptions or reductions. In order to enjoy such exemptions or reductions, the foreign lender must provide the borrower with the tax residence certificate issued by the relevant competent tax authority in that lender's jurisdiction of residence confirming that the lender is tax resident in such tax jurisdiction for the purposes of the relevant tax treaty. Such certificates are usually provided before the first payment of interest under the loan and thereafter annually until the full repayment of the loan.

6.3 Will any income of a foreign lender become taxable in your jurisdiction solely because of a loan to, or guarantee and/or grant of, security from a company in your jurisdiction?

Please refer to questions 6.1 and 6.2.

6.4 Will there be any other significant costs which would be incurred by foreign lenders in the grant of such loan/guarantee/security, such as notarial fees, etc.?

Notarisation of loan agreements and guarantees is not mandatory in Russia. No registration of loan agreements or guarantees is required in Russia. Notarial and other fees applicable to security are described in question 3.9.

6.5 Are there any adverse consequences for a company that is a borrower (such as under thin capitalisation principles) if some or all of the lenders are organised under the laws of a jurisdiction other than your own? Please disregard withholding tax concerns for purposes of this question.

A loan from a foreign entity can be considered as "controlled indebtedness" if such loan is provided or secured by a foreign entity (or a Russian entity controlled by such foreign entity).

If the amount of such "controlled indebtedness" exceeds the amount of a borrower's own equity by more than three times, the interest paid on such loan can only be considered as expenses subject to certain limits. The remaining interest is considered as dividends paid to a foreign entity and is subject to 15% taxation (unless an international treaty allows specific tax exemptions or reductions).

7 Judicial Enforcement

7.1 Will the courts in your jurisdiction recognise a governing law in a contract that is the law of another jurisdiction (a "foreign governing law")? Will courts in your jurisdiction enforce a contract that has a foreign governing law?

Russian courts should generally recognise (and enforce) foreign governing law, provided that such laws do not conflict with Russian public policy or specific mandatory rules ("*нормы непосредственного применения*") of the laws of the Russian Federation. The concepts of public policy and specific mandatory rules are not defined in the laws of the Russian Federation and, therefore, are open to interpretation by Russian courts. Furthermore, a Russian court will apply foreign law as the law of the contract only provided that such Russian court has properly established the content of the relevant foreign law in relation to the issues considered by it. If a Russian court is not in a position to establish the content of foreign law within a reasonable period of time, it is entitled to apply the laws of the Russian Federation. In any event, the laws of the Russian Federation will apply as to the matters of evidence and procedure.

7.2 Will the courts in your jurisdiction recognise and enforce a judgment given against a company in New York courts or English courts (a "foreign judgment") without re-examination of the merits of the case?

Judgments of foreign courts may be enforced in the Russian Federation only if there is a treaty between the Russian Federation and the relevant foreign jurisdiction on the mutual recognition and enforcement of court judgments or, in the absence of such a treaty, on the basis of reciprocity. As of today, no such treaty is currently in force and no formal legal procedures for reciprocal enforcement of court judgments exist between the Russian Federation and England or the Russian Federation and the United States of America, which means that the risk that judgment of an English or a New York court could not be recognised and enforced in Russia is substantial.

We are aware of some cases in which judgments of foreign courts were successfully recognised and enforced in Russia (the claimant usually provided evidence, including an expert opinion, that, under similar circumstances, a judgment of a Russian court would be enforceable in the respective foreign jurisdiction), but we are also aware of a number of cases in which enforcement of foreign court judgments was denied by Russian courts.

7.3 Assuming a company is in payment default under a loan agreement or a guarantee agreement and has no legal defence to payment, approximately how long would it take for a foreign lender to (a) assuming the answer to question 7.1 is yes, file a suit against the company in a court in your jurisdiction, obtain a judgment, and enforce the judgment against the assets of the company, and (b) assuming the answer to question 7.2 is yes, enforce a foreign judgment in a court in your jurisdiction against the assets of the company?

In general, a claim under a loan would normally be enforced in Russia upon a court order.

a) Obtaining a final and binding judgment of the arbitrazh (commercial) court of first instance usually takes three to four months. The proceeding at the court of appeal usually takes from two to three months. Enforcement of a Russian court judgment should normally be completed within two months from the day of the commencement of the enforcement proceedings, although sometimes it takes much longer due to various delays.

b) Enforcement of a foreign judgment should technically be completed within one month, but may in practice take several months.

A bad-faith debtor may substantially delay the court or enforcement proceedings by means of raising various objections in respect of the substance of foreign law as well as various procedural objections.

Under Russian law it is also possible to collect debt through an out-of-court procedure under a notary's executory endorsement made on a copy of the loan agreement. An out-of-court order of debt collection may be exercised when a loan agreement specifically provides for such enforcement option. The lender must notify the borrower at least 14 days prior to the intended collection of debt. In the absence of established court practice, it is unclear whether the out-of-court procedure can also be used by foreign banks.

7.4 With respect to enforcing collateral security, are there any significant restrictions which may impact the timing and value of enforcement, such as (a) a requirement for a public auction, or (b) regulatory consents?

Enforcement in respect of most types of pledged assets is possible both in court and out of court. In most cases, out-of-court enforcement of the pledged assets requires notarial endorsement and such endorsement is only allowed if the pledge agreement is notarised.

Out-of-court enforcement may be exercised by the following methods: public auction; private auction; retention; and private sale without an auction. Out-of-court enforcement and the particular method of enforcement shall be provided by the pledge agreement. The methods of the court enforcement are public auction, retention and private sale without an auction. Acquisition of shares in certain companies through an enforcement procedure may require certain antimonopoly and similar consents.

7.5 Do restrictions apply to foreign lenders in the event of (a) filing suit against a company in your jurisdiction, or (b) foreclosure on collateral security?

Foreign creditors should generally be treated in the same way as Russian creditors in terms of filings of suits and enforcement of the collateral security. All documents filed to the Russian arbitrazh (commercial) courts must be in Russian; any documentation in any other language must be translated into Russian, notarised and apostilled, unless originally made in Russian.

7.6 Do the bankruptcy, reorganisation or similar laws in your jurisdiction provide for any kind of moratorium on enforcement of lender claims? If so, does the moratorium apply to the enforcement of collateral security?

There is a general moratorium on enforcement of lender monetary claims since introduction of the supervision procedure (first insolvency stage). Creditors are not entitled to enforce collateral security during the supervision procedure. During the financial rehabilitation and external management procedures (further insolvency stages), secured creditors are generally entitled to enforce their security.

If a secured creditor opts for enforcement of security during the financial rehabilitation or external management procedure, it must file an application to the court. Enforcement is possible only if there is risk of loss or substantial devaluation of the security. If the debtor proves that enforcement of the security will make restoration of the debtor's solvency impossible, the court can reject the creditor's enforcement application. In such case, a secured creditor obtains full voting rights at the creditors' meetings during that bankruptcy stage. Unless enforced during the previous stages, the collateral security should generally be sold during the final bankruptcy stage (liquidation).

During bankruptcy proceedings, the company's pledged property can only be sold at an auction and any provisions in the security documents concerning the out-of-court enforcement of a pledge do not apply.

7.7 Will the courts in your jurisdiction recognise and enforce an arbitral award given against the company without re-examination of the merits?

A foreign arbitral award needs to be recognised and enforced in Russia, and the creditor must obtain an executory writ for the execution of an arbitral award. The decisions of international arbitration tribunals are generally enforceable in Russia subject to compliance with the provisions of the 1958 New York Convention and the requirements of Russian procedural legislation. The process of recognising and enforcing a foreign arbitral award must be made without re-examining in substance or re-litigating the underlying dispute. In practice, however, due to the absence of clearly established practice in this regard, Russian courts sometimes refuse to enforce foreign arbitral awards without substantiating such a decision with a sufficient legal explanation.

8 Bankruptcy Proceedings

8.1 How does a bankruptcy proceeding in respect of a company affect the ability of a lender to enforce its rights as a secured party over the collateral security?

Please refer to question 7.6.

8.2 Are there any preference periods, clawback rights or other preferential creditors' rights (e.g., tax debts, employees' claims) with respect to the security?

The proceeds obtained from the sale of pledged property are applied as follows:

a) 80% (in the event of the pledge securing a loan agreement) or 70% (in all other cases) of the proceeds (in an amount not exceeding the aggregate amount of principal and interest) is allocated to satisfy the claim of the relevant secured creditor;

b) 15% (in the event of the pledge securing a loan agreement) or 20% (in all other cases) is allocated to satisfy "first priority" and "second priority" claims if the unencumbered property of the company is insufficient to satisfy these claims; and

c) the remaining amounts are allocated to the cost of court and bankruptcy proceedings.

Russian insolvency laws provide that certain transactions qualifying as "suspicious" or "preferential transaction" may be contested in the course of insolvency.

"Suspicious" transactions are those entered into with the intention to infringe creditors' rights and entered into by the company within the three-year period preceding the commencement of the insolvency proceedings.

A so-called "preferential transaction" is a transaction entered into with a creditor or another person that results or may result in the preferential satisfaction of a claim of one of the creditors in comparison to claims of other creditors.

"Preferential transactions" may be challenged if they are entered into within the one-month period preceding the initiation of insolvency proceedings. However, the hardening period is extended to six months if a "preferential transaction" is entered into with a person who was aware of the debtor's inability to meet its obligations or in which the amount of the debtor's obligations exceeded the value of the debtor's assets. A related party is automatically deemed to have such knowledge.

The concept of "preferential transactions" captures prepayment under the existing agreements, set-offs, transfer of the debtors' property, granting security for an existing debt and other arrangements which can be frequently seen in the course of a debt restructuring. Therefore, the risk of challenge in insolvency should be carefully considered by the creditors prior to agreeing to any restructuring arrangement with a company.

8.3 Are there any entities that are excluded from bankruptcy proceedings and, if so, what is the applicable legislation?

According to the Russian Civil Code, certain entities such as political parties, religious organisations, public enterprises and most state corporations are excluded from bankruptcy proceedings. Liquidation of such entities is usually subject to the Civil Code and special laws.

8.4 Are there any processes other than court proceedings that are available to a creditor to seize the assets of a company in an enforcement?

During bankruptcy proceedings, the assets of the company can be enforced only within the insolvency proceedings. Any provisions in the security documents concerning the out-of-court enforcement of a pledge do not apply.

9 Jurisdiction and Waiver of Immunity

9.1 Is a party's submission to a foreign jurisdiction legally binding and enforceable under the laws of your jurisdiction?

Submission by parties of a contract to a foreign jurisdiction should generally be binding and enforceable if at least one party is a foreign entity and the subject matter of the contract is not subject to the exclusive jurisdiction of Russian courts.

9.2 Is a party's waiver of sovereign immunity legally binding and enforceable under the laws of your jurisdiction?

The judicial immunity of a state or another sovereign entity consists of three elements: (a) immunity from legal proceedings (i.e., immunity from being subject to the jurisdiction of courts and arbitral tribunals); (b) immunity from interim measures; and (c) immunity from enforcement. A sovereign entity can waive the immunity under an international treaty, by giving a written consent or by application to the court. The waiver of immunity is binding and enforceable in Russia.

10 Licensing

10.1 What are the licensing and other eligibility requirements in your jurisdiction for lenders to a company in your jurisdiction, if any? Are these licensing and eligibility requirements different for a "foreign" lender (i.e. a lender that is not located in your jurisdiction)? In connection with any such requirements, is a distinction made under the laws of your jurisdiction between a lender that is a bank *versus* a lender that is a non-bank? If there are such requirements in your jurisdiction, what are the consequences for a lender that has not satisfied such requirements but has nonetheless made a loan to a company in your jurisdiction? What are the licensing and other eligibility requirements in your jurisdiction for an agent under a syndicated facility for lenders to a company in your jurisdiction?

Russian law provides different legal regimes with respect to loan agreements and facility agreements. Only banks (including foreign ones) may enter into a facility agreement, while loan agreements may be made by any legal entity.

In order to carry on business, all banks incorporated in Russia must receive the Central Bank of Russia's licence. No licence is required to be obtained by a foreign bank to make a loan to a Russian company.

In terms of a cross-border transaction, it should be noted that:

a) the borrowings under a foreign currency loan can be credited to a Russian borrower's offshore account with a bank located in a state which is a member of the Organization for Economic Co-operation and Development (OECD) or the Financial Action Task Force (FATF), provided that (1) a lender is an agent of a foreign government or located in an OECD or FATF jurisdiction, and (2) the maturity of a loan exceeds two years; and

b) a Russian company, for the purposes of effecting certain payments to a non-resident, shall have an individual contract number assigned to the respective contract by an authorised bank.

11 Other Matters

11.1 Are there any other material considerations which should be taken into account by lenders when participating in financings in your jurisdiction?

One of the most important considerations which should be addressed at the financing stage is the need to obtain a pledge or mortgage from a Russian company as collateral, which is beneficial not only because it entitles a creditor to receive satisfaction of its claim from the proceeds of the sale of the pledged or mortgaged property, but also because the status of a secured creditor gives a creditor substantial comfort during insolvency proceedings.

Further considerations which must be taken into account are the requirement to obtain corporate consents and, in respect of state-owned companies, the procurement regulations.

Given the unpredictability of potential new sanctions, foreign lenders must be particularly cautious when entering into contracts with Russian counterparties. In particular, it is recommended to make sure that a lender will be able to terminate the contracts unilaterally without excessive losses if new sanctions make it illegal for the lender to perform the contract.

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1 Overview

1.1 What are the main trends/significant developments in the lending markets in your jurisdiction?

In 2018, there was a growth in corporate lending in the Serbian market. The loan demand of companies continued to rise primarily due to investment financing and, to a lesser extent, financing of current assets and debt restructuring. Past monetary policy easing by the National Bank of Serbia (NBS), Serbia's decreased risk premium, increased competition within the banking sector, rising economic activity and low interest rates in the euro zone contributed to a further rise in lending in 2018. Growth in lending continued even though a record number of non-performing loans (NPLs) were written off, reducing the share of NPLs in total loans to 6.4% in September 2018, which was the lowest percentage ever recorded.

1.2 What are some significant lending transactions that have taken place in your jurisdiction in recent years?

Major energy, telecommunication and infrastructure projects, and public and private acquisitions in Serbia have been marked by continuing involvement of IFIs. In the field of NPL acquisitions, major transactions involved various acquisitions of corporate NPLs.

2 Guarantees

2.1 Can a company guarantee borrowings of one or more other members of its corporate group (see below for questions relating to fraudulent transfer/financial assistance)?

In cases where all the companies are resident companies, there are no limitations for guaranteeing borrowings.

A resident company can guarantee borrowings of non-residents without limitations. However, the National Bank of Serbia could restrict this for public interest and financial stability reasons.

2.2 Are there enforceability or other concerns (such as director liability) if only a disproportionately small (or no) benefit to the guaranteeing/securing company can be shown?

Pursuant to Serbian law, directors have a fiduciary obligation towards their companies. In the case of non-compliance with such obligation, a company may bring a legal action against its director for indemnification of damages.

Also, in the event that the guarantor has creditors which cannot collect their matured claims, such creditors may, under the Serbian Law on Contracts and Torts, seek the annulment of the guarantee in court proceedings. In the course of proceedings, the creditors would argue that they were deprived of assets against which the claim could have been collected, due to issuance of the guarantee which is disproportionately low or has no benefit for the guarantor.

2.3 Is lack of corporate power an issue?

Limitations of a representative's powers may not be relied upon against third parties. There is an assumption that a legal representative of a company has the necessary authority to conclude all lawful legal transactions (including the issuing of warranties and other types of guarantees), and third parties cannot suffer consequences if a representative breaches its authority. Shareholders also have the right to void such transactions. In those cases, a legal representative is liable for damages suffered by the company as a result of the breach of authority, but any rights acquired by *bona fide* third parties on the basis of a voided transaction or its execution shall continue in full force and effect.

2.4 Are any governmental or other consents or filings, or other formalities (such as shareholder approval), required?

Regarding governmental filings, each foreign credit and/or loan including any means of guarantee provided for the foreign loans and their amendments must be reported to the NBS by the borrower/guarantor within 10 days from the execution of the respective agreement or its amendments.

Regarding the shareholders' approval, the prior or subsequent approval of the ¾ majority of shareholders is required only in the case of disposal of high-value assets. If the approval is not obtained, the company itself or a shareholder holding a minimum 5% of the share capital may file a legal action for the annulment of the issued guarantees or sureties by the guarantor, only under the condition that the counterparty was and had to be aware of the breach at the time of receiving the guarantee.

2.5 Are net worth, solvency or similar limitations imposed on the amount of a guarantee?

There are no set limitations.

2.6 Are there any exchange control or similar obstacles to enforcement of a guarantee?

There are no exchange control restrictions presenting an obstacle to the enforcement of a guarantee, provided that the guarantee was duly reported to the NBS.

In order to enforce the guarantee, any non-resident shall obtain a PIB (Tax Identification Number) and open a Serbian non-resident bank account. Before transferring the funds, a non-resident would have to convert the funds into foreign currency and submit evidence that all tax obligations have been fully settled.

3 Collateral Security

3.1 What types of collateral are available to secure lending obligations?

Lending obligations may be secured with any one of the following collaterals:

- pledge over movable assets;
- pledge over receivables;
- mortgage over immovable property;
- pledge over IP rights;
- pledge over securities;
- pledge over company's shares or stocks;
- pledge over bank accounts;
- cash deposit account agreement; or
- an assignment of receivables agreement.

3.2 Is it possible to give asset security by means of a general security agreement or is an agreement required in relation to each type of asset? Briefly, what is the procedure?

No, it is not.

3.3 Can collateral security be taken over real property (land), plant, machinery and equipment? Briefly, what is the procedure?

Yes. Both mortgage over land and plants and pledge over equipment and machines are established upon registration in the competent registers.

The only exception applies to aircrafts and vessels which are subject to a special regime and registered in specialised registers.

3.4 Can collateral security be taken over receivables? Briefly, what is the procedure? Are debtors required to be notified of the security?

Yes. A pledge may be established over receivables and is perfected upon registration in the pledge registry.

Notification of debtors is not a perfection criterion, but is necessary for enforcement.

An assignment of receivables is established by an agreement executed between the lender and security provider which becomes fully perfected upon the notification of debtors, provided that the assignment was duly reported to the NBS.

3.5 Can collateral security be taken over cash deposited in bank accounts? Briefly, what is the procedure?

Yes. The cash deposited into bank accounts may either be pledged or deposited in a separate special purpose account.

The pledge over cash deposited into bank accounts is established upon registration in the pledge registry and only up to the amount identified at the time of the establishment of this security.

Cash is deposited into a separate special purpose account based on the tripartite agreement executed between bank, security provider and lender. The advantage of this security is, *inter alia*, direct enforcement by the lender in case of default under a credit/loan agreement.

3.6 Can collateral security be taken over shares in companies incorporated in your jurisdiction? Are the shares in certificated form? Can such security validly be granted under a New York or English law governed document? Briefly, what is the procedure?

A pledge may be established over shares or stocks depending on the corporate form of the company.

The pledge over stocks is established upon registration in the securities register. Pledged stocks are kept in separate ownership sub-accounts.

The pledge over shares is established upon registration in the pledge registry.

The pledge over shares or stocks cannot be validly granted under any foreign law.

3.7 Can security be taken over inventory? Briefly, what is the procedure?

Yes. A pledge over inventory is established upon registration in the pledge registry.

3.8 Can a company grant a security interest in order to secure its obligations (i) as a borrower under a credit facility, and (ii) as a guarantor of the obligations of other borrowers and/or guarantors of obligations under a credit facility (see below for questions relating to the giving of guarantees and financial assistance)?

In the case a resident company is a borrower under a credit agreement executed with a non-resident, the borrower is free to secure the claim from the credit agreement by providing any of the above collaterals.

The resident company may also guarantee borrowings of non-residents and therefore provide all collaterals listed above, unless the NBS restricts guaranteeing.

3.9 What are the notarisation, registration, stamp duty and other fees (whether related to property value or otherwise) in relation to security over different types of assets?

The registration fees differ with the type of asset and may depend on the value of principal receivable (e.g. mortgage or pledge) or may be determined at a fixed amount (e.g. pledge over stocks).

Notarisation fees cannot be calculated precisely in advance. They may vary and depend on several factors such as value of mortgaged property, value of receivables, number of counterparts requested by the parties, etc.

3.10 Do the filing, notification or registration requirements in relation to security over different types of assets involve a significant amount of time or expense?

The deadlines for registration of security over different type of assets are prescribed by law. For example, a pledge is registered within five days from the day of submission of registration application, while mortgage is registered within five business days. However, some deadlines may be significantly prolonged.

3.11 Are any regulatory or similar consents required with respect to the creation of security?

Besides the perfection requirements described above, collaterals established by a resident company in favour of a non-resident creditor or as a guarantee for another non-resident borrower must be reported to the NBS.

The constitutional documents of the company may also prescribe the shareholders' or other consents or approvals. Other potential requirements may only be estimated on a case-by-case basis.

3.12 If the borrowings to be secured are under a revolving credit facility, are there any special priority or other concerns?

No specific concerns relate to the borrowings secured under a revolving credit facility, except the mandatory reporting to NBS and mandatory repayment terms.

3.13 Are there particular documentary or execution requirements (notarisation, execution under power of attorney, counterparts, deeds)?

In general, a written form of the security agreements is the only requirement unless otherwise prescribed by law (e.g. certified signatures on share pledge agreement or solemnised mortgage agreement/executed in the form of notarial deed).

If the security agreement is executed by a proxy, the power of attorney must follow the form of the agreement (e.g. power of attorney must be issued in the form of notarial deed for execution of the mortgage agreement in subject form).

4 Financial Assistance

4.1 Are there prohibitions or restrictions on the ability of a company to guarantee and/or give security to support borrowings incurred to finance or refinance the direct or indirect acquisition of: (a) shares of the company; (b) shares of any company which directly or indirectly owns shares in the company; or (c) shares in a sister subsidiary?

Regarding shares of any company which directly or indirectly owns shares in the company, joint stock or limited liability companies may not directly or indirectly provide any sort of financial support to their members, employees or third parties for the acquisition of equity interests in the company, including in particular loans, guarantees, sureties, collateral, etc. Any of these transactions would be considered null and void, exposing the company to a fine ranging from approx. EUR 800 to EUR 8,000.

Regarding shares in a sister subsidiary, providing this financial support to anyone acquiring equity in such companies is not strictly forbidden.

5 Syndicated Lending/Agency/Trustee/Transfers

5.1 Will your jurisdiction recognise the role of an agent or trustee and allow the agent or trustee (rather than each lender acting separately) to enforce the loan documentation and collateral security and to apply the proceeds from the collateral to the claims of all the lenders?

An agent or trustee, as exist in English law, is not recognised by Serbian law.

5.2 If an agent or trustee is not recognised in your jurisdiction, is an alternative mechanism available to achieve the effect referred to above which would allow one party to enforce claims on behalf of all the lenders so that individual lenders do not need to enforce their security separately?

Serbian law recognises an institution of a "security agent" only regarding the pledge of movable assets and the immovable property mortgage.

The Serbian Law on Pledges on Registered Movable Property prescribes that one or more pledgees/lenders may designate one of the lenders or a third party, i.e. the security agent, to undertake all legal actions in order to protect and settle the pledged receivable. In this case, the security agent shall have the rights of a pledgee in relation to the pledger and the name of the security agent shall be registered in the pledge registry instead of all of the pledgees/lenders.

As per the mortgage over immovable property, the Mortgage Law also prescribes that one or more mortgage lenders may designate one of the lenders or a third party to undertake all legal actions in order to protect and settle receivables secured by a mortgage.

5.3 Assume a loan is made to a company organised under the laws of your jurisdiction and guaranteed by a guarantor organised under the laws of your jurisdiction. If such loan is transferred by Lender A to Lender B, are there any special requirements necessary to make the loan and guarantee enforceable by Lender B?

The loan transfer, i.e. assignment of receivables, is possible when the banks and/or resident legal entities and/or non-resident legal entities are transferring claims and debts of residents that arise only from foreign credit operations.

The assignment may be performed only on the basis of an agreement concluded by all parties or a statement of the resident confirming he is duly informed about the transfer, provided that the assignment was duly reported to the NBS.

6 Withholding, Stamp and Other Taxes; Notarial and Other Costs

6.1 Are there any requirements to deduct or withhold tax from (a) interest payable on loans made to domestic or foreign lenders, or (b) the proceeds of a claim under a guarantee or the proceeds of enforcing security?

Withholding tax shall be payable on the interest paid by a Serbian resident borrower, to a non-resident lender, at a 20% tax rate (or

25%, if a lender is a tax haven resident), unless a double tax treaty prescribes otherwise. The double taxation treaties of the Republic of Serbia either prescribe a 0% rate or a diminished rate of 10%.

No tax deduction/withholding tax applies to the proceeding of a claim under a guarantee or the enforcement of security, unless the proceeds from the guarantee/enforcement of security are used to settle any part of the interest, in which case the non-resident lender is obliged to submit the tax return and pay appropriate tax on such interest.

6.2 What tax incentives or other incentives are provided preferentially to foreign lenders? What taxes apply to foreign lenders with respect to their loans, mortgages or other security documents, either for the purposes of effectiveness or registration?

There are no incentives provided for foreign lenders.

No taxes shall be applicable to mortgages or other securities, though other costs could arise from registration of mortgages or securities.

6.3 Will any income of a foreign lender become taxable in your jurisdiction solely because of a loan to, or guarantee and/or grant of, security from a company in your jurisdiction?

No, the income of the foreign lender will not become taxable solely on the ground of granting a loan, guarantee, or security. The only tax, therefore, would be the tax on interest discussed above under question 6.1.

6.4 Will there be any other significant costs which would be incurred by foreign lenders in the grant of such loan/guarantee/security, such as notarial fees, etc.?

Please see question 3.9. – there are no costs other than presented above.

6.5 Are there any adverse consequences for a company that is a borrower (such as under thin capitalisation principles) if some or all of the lenders are organised under the laws of a jurisdiction other than your own? Please disregard withholding tax concerns for purposes of this question.

There will be no adverse consequences in this respect solely because of the fact that the lender is a foreign company.

7 Judicial Enforcement

7.1 Will the courts in your jurisdiction recognise a governing law in a contract that is the law of another jurisdiction (a "foreign governing law")? Will courts in your jurisdiction enforce a contract that has a foreign governing law?

Serbian courts recognise foreign governing laws. Contracting parties are free to choose the applicable law for their contract. This freedom can, however, be limited by mandatory provisions and Serbian public policy.

Serbian courts will enforce a contract with a foreign governing law, provided it is legal, binding, valid, and that Serbian courts have jurisdiction over the contract.

7.2 Will the courts in your jurisdiction recognise and enforce a judgment given against a company in New York courts or English courts (a "foreign judgment") without re-examination of the merits of the case?

Judgments rendered by New York courts and English courts will be enforceable by Serbian courts without re-trial or re-examination of the merits of the case if:

1. the jurisdiction of the foreign court is found to be legitimate under Serbian law or the jurisdiction of such foreign court was established by the parties in the relevant documents;
2. the foreign judgment is final (non-appealable) and enforceable according to the law by which it is rendered; and
3. none of the following reasons set out below are applicable to it:
   (i) the recognition of the decision would violate Serbian public policy;
   (ii) the party against whom the decision was made did not attend the proceedings in person or by way of a representative because the summons, statement of claim or other document on the basis of which the proceedings were initiated was not properly served at his domicile or residence or in a timely fashion in order to allow adequate time to prepare his defence;
   (iii) a final judgment has been served or a proceeding has been commenced with respect to the same legal matter and factual background between the same parties prior to the commencement of the foreign proceedings; and
   (iv) a Serbian court or other authority has exclusive jurisdiction (for example, proceedings related to real estate located in Serbia).

7.3 Assuming a company is in payment default under a loan agreement or a guarantee agreement and has no legal defence to payment, approximately how long would it take for a foreign lender to (a) assuming the answer to question 7.1 is yes, file a suit against the company in a court in your jurisdiction, obtain a judgment, and enforce the judgment against the assets of the company, and (b) assuming the answer to question 7.2 is yes, enforce a foreign judgment in a court in your jurisdiction against the assets of the company?

Depending on a specific case, it may take a couple of years to reach a final and non-appealable judgment.

The procedure of recognising a foreign judgment may take up to two years.

The enforcement procedure itself generally takes one to three years, based on the complexity of the case, the location of the assets and the cooperation of the debtor, etc.

7.4 With respect to enforcing collateral security, are there any significant restrictions which may impact the timing and value of enforcement, such as (a) a requirement for a public auction, or (b) regulatory consents?

There are two types of enforcement in Serbia: (a) judicial enforcement; and (b) out-of-court enforcement.

In order to commence a judicial enforcement procedure, the creditor must obtain an enforceable document such as a pledge statement. The primary method of realisation in a judicial enforcement procedure is a public sale organised by a bailiff via an auction.

An out-of-court enforcements procedure is less formal and costly than a judicial enforcement. However, secured creditors generally prefer judicial enforcement, given it has a more predictable and certain method.

As to the volume of costs related to enforcement, they vary in accordance with the amount of the claim and pledged collateral, and usually do not exceed EUR 50,000 in large transactions.

7.5 Do restrictions apply to foreign lenders in the event of (a) filing suit against a company in your jurisdiction, or (b) foreclosure on collateral security?

No general restrictions apply, but a foreign lender:

- in the event of (a):
  - (i) may be required to pay a bond for payment of the judgment in front of the national courts to ensure that the costs of the legal procedure are to be covered;
  - (ii) is required to appoint a delivery agent if it does not have a Serbian registered seat; and
  - (iii) can be exempt from the payment of court costs only if there is a reciprocity in that matter between Serbia and country of its origin.
- in the event of (b):
  - (i) is required to register a bank account in one of the banks operating in Serbia in order to initiate enforcement and finally receive collected funds; and
  - (ii) is required to file a request before the Serbian Tax Office for tax confirmation that collected funds are not subject to any local tax, prior to transferring the received funds from a Serbian bank account to a domicile account.

7.6 Do the bankruptcy, reorganisation or similar laws in your jurisdiction provide for any kind of moratorium on enforcement of lender claims? If so, does the moratorium apply to the enforcement of collateral security?

Upon the passing of a court ruling on pre-bankruptcy proceedings, a temporary moratorium starts. In case the bankruptcy procedure is ordered and published by the court, the temporary moratorium ends and a general moratorium is granted automatically, meaning all pending enforcement is suspended and no new enforcement can be commenced, until the end of bankruptcy proceedings.

In the case of bankruptcy, all creditors can collect their claims against the debtor in bankruptcy proceedings only.

On the other hand, the debtor or the insolvency administrator is obliged to provide adequate protection of the pledged assets to ensure the value and condition of such assets remain unchanged.

The bankruptcy judge can lift the moratorium against pledged assets if one of the following conditions is met:

1. the debtor or the insolvency administrator did not adequately protect pledged assets, meaning pledged assets would be at some risk; or
2. the value of the pledged assets decreases, and there is no other remedy to provide adequate and effective protection against the reduction of value.

Instead of deciding to lift the moratorium, the bankruptcy judge may pass a ruling to impose adequate protection of pledged assets by implementing one or more of the following measures:

1. payment of regular monetary compensation to a secured creditor, in an amount which is equal to the amount for which the value of the assets is reduced or the compensation for actual or estimated losses;
2. the replacement of assets or determination of additional assets that will serve as collateral in order to compensate for a decrease in value;
3. repair, maintenance, insurance or measures of special security and custody of the assets; and/or
4. other protective measures or other types of compensation which the bankruptcy judge considers to protect the value of the assets of the secured creditor.

Pursuant to the recently enacted Law on Financial Collaterals, opening a bankruptcy shall not affect the provided financial collaterals if they were provided before the opening of the bankruptcy. If the financial collaterals were provided, acquired, or altered on the date of opening of the bankruptcy, they will remain valid if the secured creditor proves that it was not aware and should have not been aware of the opening of the bankruptcy. This is applicable only to agreements on financial collaterals which could be concluded only between qualified investors, as defined in the Law on Financial Collaterals.

7.7 Will the courts in your jurisdiction recognise and enforce an arbitral award given against the company without re-examination of the merits?

Serbia is a contracting party to the New York Convention on Recognition and Enforcement of Foreign Arbitral Awards; thus all arbitral awards rendered in the territory of another Contracting Party State shall be recognised and enforced without a re-examination of the merits of the case.

An arbitral award has to, however, fulfil the following conditions:

1. it has to be rendered by a competent court of arbitration;
2. it has to be rendered with respect to the parties' right to participate in the arbitral proceedings (with special consideration on appropriate delivery of relevant documents);
3. it has to be final; and
4. none of the following reasons set out below are applicable to it:
   - (a) the arbitral tribunal has exceeded its given authority;
   - (b) there has been a breach of an arbitration agreement;
   - (c) the arbitral award was based on a false statement of a witness or expert or on a forged document or award;
   - (d) the subject of the dispute is not arbitrable; or
   - (e) the recognition of the arbitral award would be against Serbian public policy.

8 Bankruptcy Proceedings

8.1 How does a bankruptcy proceeding in respect of a company affect the ability of a lender to enforce its rights as a secured party over the collateral security?

Bankruptcy proceedings decisively affect the lender's ability to enforce its rights as a secured party over collateral security. From the moment bankruptcy is commenced, no enforcement against the debtor is allowed and all creditors can satisfy their claims in bankruptcy proceedings only.

Regarding other relevant enforcement issues during bankruptcy proceedings, please refer to question 7.6.

8.2 Are there any preference periods, clawback rights or other preferential creditors' rights (e.g., tax debts, employees' claims) with respect to the security?

A company's creditor or bankruptcy manager may contest a company's transactions entered into during specified periods prior to filing for the insolvency.

There are five different types of vulnerable transactions that are exposed to such claw-back claims, as follows:

(i) customary settlement – entered into six months prior to a bankruptcy petition filling;

(ii) incongruent settlement – entered into 12 months prior to a bankruptcy petition filling;

(iii) directly detrimental transaction – entered into six months prior to a bankruptcy petition filling or afterwards;

(iv) intentionally detrimental transactions – entered into five years prior to a bankruptcy petition filling; or

(v) transactions without or insignificant consideration – entered into five years prior to a bankruptcy petition filling.

There are no preference periods or other preferential creditors' rights with respect to the security.

8.3 Are there any entities that are excluded from bankruptcy proceedings and, if so, what is the applicable legislation?

The following entities cannot be the subject of a bankruptcy proceeding: the Republic of Serbia; autonomous provinces and local self-government units; funds or pension funds; legal entities founded by the Republic of Serbia such as autonomous provinces or local self-government units, which are financed exclusively or predominantly through the allocated public revenues or from the budget, i.e. the budget of the autonomous province and the local self-government unit; the National Bank of Serbia; the Central Register, depot and clearing of securities; and public agencies.

For the obligations of the abovementioned entities, there is a joint and several liability of their founders and owners, as well as their members and shareholders.

Also, special legislation is applicable on bankruptcy proceedings of banks and insurance organisations.

8.4 Are there any processes other than court proceedings that are available to a creditor to seize the assets of a company in an enforcement?

Once the bankruptcy proceeding starts, there are no other means to seize the assets of a company.

However, close-out netting under agreements on financial collaterals between the qualified investors concluded in line with the Law on Financial Collaterals shall be enforced under this law.

9 Jurisdiction and Waiver of Immunity

9.1 Is a party's submission to a foreign jurisdiction legally binding and enforceable under the laws of your jurisdiction?

Yes (provided that no national asset is involved).

9.2 Is a party's waiver of sovereign immunity legally binding and enforceable under the laws of your jurisdiction?

Yes (provided that no national asset is involved).

10 Licensing

10.1 What are the licensing and other eligibility requirements in your jurisdiction for lenders to a company in your jurisdiction, if any? Are these licensing and eligibility requirements different for a "foreign" lender (i.e. a lender that is not located in your jurisdiction)? In connection with any such requirements, is a distinction made under the laws of your jurisdiction between a lender that is a bank *versus* a lender that is a non-bank? If there are such requirements in your jurisdiction, what are the consequences for a lender that has not satisfied such requirements but has nonetheless made a loan to a company in your jurisdiction? What are the licensing and other eligibility requirements in your jurisdiction for an agent under a syndicated facility for lenders to a company in your jurisdiction?

The activity of granting credits in the Republic of Serbia is exclusively performed by the banks as financial institutions licensed by the NBS, whereas loans can be freely granted by banks, companies and other entities, as well as by natural persons.

Serbian law authorises foreign banks and foreign legal entities to grant credits and loans to residents without any restrictions. However, please note that certain limitations may occur when repaying the credit/loan:

- a credit may be repaid only after the expiration of one year from the date of its disbursement, and if drawn in tranches, after the expiration of one year from the date of the drawdown of each individual tranche, unless the credit is granted by a non-resident incorporated in an EU Member State, when it can be repaid before this term;
- if a credit is repaid in several instalments, repayment can only begin after expiration of six months from the date of each use of the credit and the repayment is carried out in proportionate instalments until the total amount repayment, unless the credit is granted by a non-resident incorporated in an EU Member State, when the repayment may commence before this term;
- banks may use credits with a repayment term shorter than one year, in which case they may start repayment before the expiration of six months from the date of disbursement;
- residents – legal entities and entrepreneurs – may use credits with a repayment term shorter than one year only for the purposes of financing the purchase, processing and production of agricultural products or financing exports of goods and services, but may not start repayment before the expiration of three months from the date of each drawdown on the credit, unless the credit is granted by a non-resident incorporated in an EU Member State, when it can be repaid before this term; and
- residents – natural persons – may take foreign credits and loans with a repayment term over one year, provided the funds are credited to the account of that resident with a bank, while a resident branch of a foreign legal entity may take such credits and loans from a non-resident founder, unless the credit is granted by a non-resident incorporated in an EU Member State, when it can be repaid before this term.

Foreign credit operations and loans, and any amendments thereof, have to be reported to the NBS by a borrower in order to be utilised. Failure to notify the NBS represents a misdemeanour imposing a fine on a resident legal entity.

Serbian law does not prescribe any additional conditions that a foreign bank or a foreign lender should fulfil. The same applies to the agent under a syndicated facility.

11 Other Matters

11.1 Are there any other material considerations which should be taken into account by lenders when participating in financings in your jurisdiction?

The response to this question depends on the specific details of each particular case.

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Chapter 69

Singapore

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1 Overview

1.1 What are the main trends/significant developments in the lending markets in your jurisdiction?

The banking system in Singapore remained resilient in 2018 against a backdrop of rising uncertainty in the macroeconomic landscape from events such as, *inter alia*, investigations into transactions relating to 1Malaysia Development Berhad, the impasse over the terms of Britain's exit from the European Union as well as trade tensions between the US and China.

Despite the increased uncertainty, overall loan volume numbers in 2018 saw a year-on-year increase from 2017. The Monetary Authority of Singapore (***MAS***) has also reported that asset quality of banks' loan portfolios has also improved despite the pick-up in bank lending. Weaker segments, particularly the Transport, Storage and Communications sector, have also seen declines in non-performing loan ratios. Nevertheless, MAS has advised that banks should continue to maintain good credit underwriting standards and adequate provisioning buffers to mitigate potential credit risks.

In terms of future outlook, the Singapore government has reflected a keen interest in positioning Singapore as Asia's infrastructure hub given Asia's need for infrastructure is more urgent than ever, as economies in the region expand rapidly and the population of urban residents across Asia rises. In 2018, the government announced the creation of a new Infrastructure Office named 'Infrastructure Asia' to bring together local and international players from across the entire value chain – covering developers, institutional investors, management and professional services providers – to develop, finance and execute infrastructure projects. This development would make Singapore even more attractive as a launch pad for investors and developers for their overseas ventures and Singapore-based banks which already manage 60% of finance transactions in Southeast Asia should be well placed to leverage on these opportunities.

There has also been notable interest in embracing the global trend of 'Green Finance'. Taken broadly, Green Finance is a range of financial services and products, including debt, equity and insurance, that promotes the efficient flow of capital towards activities and projects that are more sustainable and responsive to addressing environmental and climate concerns. Many European countries are now leading proponents for Green Finance. In Asia, China has become the world's leading issuer of green bonds. On the local front, MAS and the International Finance Corporation (***IFC***) had in June 2018 signed a memorandum of understanding to encourage green bond issuances by financial institutions (***FIs***) in Asia in two ways: (1) enhancing the awareness and knowledge of professionals working in FIs on green finance issues through capacity building programmes; and (2) promoting the use of internationally recognised green bond standards and frameworks. MAS and IFC will also provide funding support through various grants and financial training schemes.

1.2 What are some significant lending transactions that have taken place in your jurisdiction in recent years?

One of the more significant loan transactions in 2018 was the US$1.8 billion syndicated loan facility granted to Wii Pte Ltd, a wholly-owned subsidiary of Wilmar International Limited (***Wilmar***) (Asia's leading agribusiness group, headquartered in Singapore) to finance general corporate and working capital requirements of Wilmar and its subsidiaries, including refinancing of existing debt. The facility was entered into with a multitude of lenders including, *inter alia*, the three major local banks and major foreign banks such as HSBC and Bank of China Limited. Wilmar was also involved in the Green Finance scene, partnering OCBC in the largest sustainability-linked bilateral loan by a Singapore bank. The deal which was announced in June 2018 pegged the interest rate of the agribusiness group's existing US$200 million revolving credit facility to its sustainability performance.

Some further Green Finance deals in 2018 include Singapore property investment and development company, Ho Bee Land Limited (***Ho Bee***) obtaining a £200 million bridged Green Loan from HSBC – the first of its kind in Singapore. The loan will be used by Ho Bee to acquire a 21-storey commercial development in London, Ropemaker Place, which has achieved a green building pre-certification with Leed (Leadership in Energy and Environmental Design) and excellent rating with Breeam, a sustainability assessment scheme.

On the debt capital markets scene, 2018 saw Temasek Financial (IV) Private Limited establish a S$5 billion guaranteed medium term note programme which allowed for notes to be offered to retail investors in Singapore pursuant to the regulatory frameworks introduced by the MAS and the Singapore Exchange Securities Trading Limited in 2016 to facilitate retail access to debt securities. 2017 also saw the first green bond issuance in Singapore by a financial institution, under the MAS Green Bond Grant Scheme when DBS Group Holdings Ltd successfully priced the issue of US$500 million floating rate green bonds due 2022 under its US$30 billion Global Medium Term Note Programme.

2 Guarantees

2.1 Can a company guarantee borrowings of one or more other members of its corporate group (see below for questions relating to fraudulent transfer/financial assistance)?

Yes, subject to there being sufficient corporate benefit and no contravention of specific rules under the Companies Act (Cap. 50) (***CA***); for example, relating to guarantee of loans to companies related to directors and provision of financial assistance.

S157 of the CA provides that a director of a company "shall at all times act honestly and use reasonable diligence in the discharge of the duties of his office". This statutory statement is in addition to the directors' duty under general law to exercise their discretion *bona fide* in what they consider is in the best interest of the company. The directors of a company have to ensure there is sufficient corporate benefit in giving any guarantee, including a guarantee for the borrowings of one or more members of its group.

A commonly asked question is whether directors can, in giving a guarantee, consider the interests of the corporate group as a whole. The theoretical rule is that companies within a group are separate legal entities. However, in practice, companies are often part of larger groups and it is generally accepted that there is corporate benefit on the face of a transaction involving a holding company guaranteeing the obligations of its subsidiary. It would be harder, however, to show corporate benefit in a subsidiary guaranteeing the debts of its holding or sister companies and in such situations, it would be prudent to have the shareholders of the company sanction the giving of the guarantee.

In addition, companies have to be mindful of the prohibition under s163 of the CA relating to the guarantee of loans, quasi-loans or credit transactions to companies related to directors. There are exceptions to this prohibition, including where the companies involved are in a subsidiary/holding company relationship or are subsidiaries of the same holding company in the legal sense. Members of a corporate group in the legal sense are therefore generally exempted. They are, however, not exempted if they are non-subsidiary affiliates and directors have to be careful then to conduct the necessary enquiry to ensure there is no contravention of the section. With effect from 3 January 2016, a new exception was introduced to allow for prior approval by the company in general meeting to permit such transactions. Where practicable (for example when dealing with private companies), lenders are likely to require such prior approval by shareholders to be obtained to do away with the risk of triggering this prohibition.

Regard also has to be given to the prohibition against giving of financial assistance and other considerations where a company is insolvent, as set out in sections 4 and 8 below.

2.2 Are there enforceability or other concerns (such as director liability) if only a disproportionately small (or no) benefit to the guaranteeing/securing company can be shown?

See question 2.1 above. In giving a guarantee, the directors of the company have to ensure there is sufficient corporate benefit. If the corporate benefit to the guaranteeing company is disproportionately small or there is no corporate benefit, then there may be an issue as to whether the directors in giving the guarantee are in breach of their fiduciary duties.

Where directors have given a guarantee in breach of their fiduciary duties, the guarantee may be set aside if the lender had knowledge of the impropriety and the offending directors may be both civilly and criminally liable for their breach.

Other considerations where a company is insolvent are set out in section 8 below.

2.3 Is lack of corporate power an issue?

Unless otherwise limited or restricted by the provisions of its own constitutive documents, a company has full capacity to perform any act, including entering into guarantees. Caution should be taken as there are, however, companies with old forms of constitutive documents that still contain restrictions and limits on the grant of guarantees and if so, such restrictions will continue to apply.

The effect of the lack of corporate power in the grant of a guarantee, whilst it does not invalidate the guarantee *per se*, may be asserted or relied upon in, amongst others, proceedings against the company by any member of the company or, where the company has issued debentures secured by a floating charge over all or any of the company's property, by the holder of any of those debentures to restrain the doing of any act or transfer of any property by the company. The court may, in such a situation, exercise discretion to set aside and restrain the performance of the guarantee but allow for compensation for loss or damage sustained.

The CA deems the power of the directors to bind the company, or authorise others to do so, to be free of any limitation under the company's constitution, in favour of persons dealing with the company in good faith. It remains to be seen if the Singapore courts will find that knowledge of an act being beyond the powers of the directors under the constitutive documents of the company will, by itself, be sufficient to establish a lack of good faith for purposes of this new provision.

2.4 Are any governmental or other consents or filings, or other formalities (such as shareholder approval), required?

No governmental consents or filings are generally required.

A guarantee will be required to be lodged with the companies' registry in Singapore, the Accounting and Corporate Regulatory Authority (***ACRA***), only if by its terms it also seeks to create a charge or agreement to charge within the meaning of s131 of the CA.

In terms of formalities, a contract of guarantee has to be in writing and signed by the person sought to be rendered liable under the guarantee. Board resolutions approving the terms, execution and performance of the guarantee should be passed. Shareholders' approval should also be obtained if there is any potential issue of lack of corporate benefit and breach of directors' duties, or triggering of s163 of the CA or where it is otherwise required by statute (for example, to whitewash the transaction) or the constitutive documents of the company.

2.5 Are net worth, solvency or similar limitations imposed on the amount of a guarantee?

No, unless otherwise restricted by the constitutive documents of the company.

If, however, the amount guaranteed is clearly disproportionate to the corporate benefit received, the issues discussed in question 2.2 above would arise.

Other considerations where a company is insolvent are set out in section 8 below.

2.6 Are there any exchange control or similar obstacles to enforcement of a guarantee?

There are no exchange controls in Singapore which would act as an obstacle to the enforcement of a guarantee.

3 Collateral Security

3.1 What types of collateral are available to secure lending obligations?

Under Singapore law, all types of collateral may potentially be available to secure lending obligations, provided the grant thereof is not against public policy.

Common types of collateral that can be used include real property (land and buildings), personal chattels, debts and other receivables, stocks and shares and other choses in action.

3.2 Is it possible to give asset security by means of a general security agreement or is an agreement required in relation to each type of asset? Briefly, what is the procedure?

It is possible to give asset security by means of a general security agreement; for example, by way of a debenture seeking to take security over different classes of assets, save to the extent that a statutorily prescribed form is required (e.g. to effect a legal mortgage over land under the Land Titles Act (Cap. 157) (***LTA***) or take a legal assignment over book-entry securities).

The main types of security interests that can be created under Singapore law are mortgages, charges, liens and possessory pledges, and the appropriate method of taking security would depend on the nature of the asset over which the security is to be taken and the extent of security required.

Different classes of assets will also be subject to different procedures and perfection requirements.

3.3 Can collateral security be taken over real property (land), plant, machinery and equipment? Briefly, what is the procedure?

<u>Land</u>

Yes, a legal or equitable mortgage/charge or assignment of sale and purchase/lease/building agreement with mortgage-in-escrow is commonly granted over real property (land and to the extent immovable, plant and buildings thereon). The type of security will depend on, amongst other factors, whether title over the land has been issued, the land type and the type of holding.

There are two types of land in Singapore – common law titled land and land under the LTA. Virtually all land in Singapore has been brought under the LTA. A legal mortgage for land under the LTA has to be in a statutorily prescribed form and registered with the Singapore Land Authority (***SLA***). Where title has not been issued for land under the LTA, a lender would take an equitable mortgage over the sale and purchase agreement, lease or building agreement in relation to the land, with an accompanying mortgage-in-escrow for perfection upon issue of title.

Commonly, an appropriate caveat may also be lodged with the SLA against the land to protect the lender's interest during the time between the acceptance of the facility and the registration and perfection of the security.

Related security like an assignment over insurances, rental and sale proceeds and agreements and in the case of land under construction, assignment over construction contracts and performance bonds are usually also taken.

Procedure and perfection steps briefly include taking of relevant title documents, registration with the SLA (or Registry of Deeds, if applicable), registration of the charge with ACRA under s131 of the CA, stamping, consents from lessor of the land or other third parties (if applicable), corporate authorisations, whitewash/shareholders' approval (if applicable), etc. In practice, some banks require shareholders' approval where the assets to be mortgaged/charged constitute the whole or substantially the whole of the company's undertaking or property.

<u>Machinery and equipment</u>

A fixed charge granted by way of a debenture or charge is commonly taken over machinery and equipment.

Registration with ACRA will be required under s131 of the CA. Other perfection steps are (to the extent applicable) discussed above.

3.4 Can collateral security be taken over receivables? Briefly, what is the procedure? Are debtors required to be notified of the security?

Yes, security over receivables (being choses in action) can be taken by way of an assignment or charge (fixed or floating) through a deed of assignment/charge or a debenture, depending on the entire security package to be taken. Generally, lenders may also, for control purposes, obtain a charge (fixed or floating) over the accounts into which the receivables are paid (see question 3.5 below).

In order to take a legal assignment over receivables, it has to be in writing with express notice in writing given to the debtor of the receivables. The giving of notice also enables the lender to secure priority.

A charge to be taken over receivables can be fixed or floating. Where the lender is able to control the receivables and they are not subject to withdrawals without consent, a legal assignment or fixed charge may be created over the subject receivables. Often, however, the receivables are part of the ongoing business of the security provider and the lender does not seek to take control over the same. In such a situation, only a floating charge may be created in substance, regardless of how the charge is termed or labelled in the documentation.

Registration with ACRA will be required if the charge is floating or the receivables fall under one of the prescribed categories of s131 of the CA. Other perfection steps are, to the extent applicable, discussed in question 3.3 above.

3.5 Can collateral security be taken over cash deposited in bank accounts? Briefly, what is the procedure?

Yes, security over cash deposited in bank accounts (being choses in action) can be taken in the same way as receivables and the principles and requirements in question 3.4 apply.

In practice, it may be difficult to obtain a legal assignment or fixed charge over cash deposited in a bank account unless the bank account is opened with and controlled by the lender. Where that is not practicable and/or it is necessary to enable the chargor to make withdrawals from the bank account freely, the lender may be left with taking only a floating charge over the account.

Registration with ACRA will be required if the charge is floating or if it falls under one of the prescribed categories of s131 of the CA. Other perfection steps are as discussed in question 3.3 above.

3.6 Can collateral security be taken over shares in companies incorporated in your jurisdiction? Are the shares in certificated form? Can such security validly be granted under a New York or English law governed document? Briefly, what is the procedure?

Shares in Singapore may be in certificated/scrip or scripless form.

Where shares are certificated, a legal or equitable mortgage may be taken over the shares. A legal mortgage may be granted by way of a share mortgage, accompanied by a transfer and registration of the shares and delivery of share certificates in the mortgagee's name. The procedures and restrictions for the transfer will be set out in the company's constitutive documents and the CA. An equitable mortgage/charge may be granted by way of a share mortgage/charge and deposit of share certificates together with a blank transfer executed by the mortgagor/chargor on the agreement that the mortgagee/chargee may complete the transfer forms upon occurrence of a default event under the facility or by notice.

Where shares are in scripless form (i.e. book-entry securities, being essentially listed shares of companies on the Singapore stock exchange – Singapore Exchange Limited), by statute, a different regime will apply. Security may be taken over such shares by way of a statutory assignment or statutory charge in prescribed form registered with the Central Depository (Pte) Limited in Singapore or by common law subject to certain prescribed requirements.

There is no specific restriction to prohibit the general terms of security over shares to be governed by New York or English law, but the creation and grant of security over shares should be governed by Singapore law as the shares of Singapore companies (and exercise of certain enforcement rights) are regulated by the CA and local property rules.

Registration with ACRA will be required if the charge is floating or the shares fall under one of the prescribed categories of s131 of the CA. Other perfection steps are as discussed in question 3.3 above.

3.7 Can security be taken over inventory? Briefly, what is the procedure?

Yes, a floating charge is most commonly created over inventory. The chargor in this instance will generally be permitted to deal with the inventory in the ordinary course of its business until the occurrence of a default event under the facility or notice from the lender.

Registration with ACRA is required under s131 of the CA. Other perfection steps are as discussed in question 3.3 above.

3.8 Can a company grant a security interest in order to secure its obligations (i) as a borrower under a credit facility, and (ii) as a guarantor of the obligations of other borrowers and/or guarantors of obligations under a credit facility (see below for questions relating to the giving of guarantees and financial assistance)?

Yes for both cases, subject to considerations such as the existence of corporate power and corporate benefit, s162/163 of the CA (prohibition on loans, quasi-loans and credit transactions to directors and related companies) and financial assistance etc., as set out in this chapter.

3.9 What are the notarisation, registration, stamp duty and other fees (whether related to property value or otherwise) in relation to security over different types of assets?

The fee for the registration of a charge/security instrument with ACRA in accordance with s131 of the CA is currently S$60 per charge.

In addition, security interest over certain assets (e.g. aircraft, ships, intellectual property rights and land) will need to be registered at specialist registries and additional fees will be payable. For example, the fee payable for the registration of a mortgage over land with the SLA is currently S$68.30 per mortgage.

Stamp duty is payable on a mortgage, equitable mortgage or debenture of any immovable property and stock or shares. A legal mortgage is subject to *ad valorem* duty at the rate of 0.4% of the amount of facilities granted on the mortgage of immovable property or stocks and shares, subject to a maximum of S$500. An equitable mortgage is subject to *ad valorem* duty at the rate of 0.2% of the amount of facilities granted on the mortgage of immovable property, subject to a maximum of S$500.

Notarisation is not required for security documents which are executed and to be used in Singapore.

3.10 Do the filing, notification or registration requirements in relation to security over different types of assets involve a significant amount of time or expense?

The charge/security instrument to be lodged with ACRA under s131 of the CA must be lodged within 30 calendar days after the creation of the charge where the document creating the charge is executed in Singapore (or within 37 calendar days if executed outside Singapore). The filing (once filing forms are completed) is instantaneous and confirmation of registration from ACRA will normally take two to three business days.

The timeframe for registration at specialist registries differs according to each registry. For example, the registration of a mortgage with the SLA may take several weeks if complex and involving multiple units. In the interim, a lender may protect its interest by the lodgement of a caveat with the SLA.

Fees payable for such registrations are as discussed in question 3.9 above.

3.11 Are any regulatory or similar consents required with respect to the creation of security?

Regulatory consents may be required in certain circumstances; for example, where the subject land is state land leased from the Government or Government statutory boards like the SLA and Urban Redevelopment Authority.

3.12 If the borrowings to be secured are under a revolving credit facility, are there any special priority or other concerns?

Under Clayton's rule, security taken over a revolving loan may be 'reducing' as the loan 'revolves' as a result of the 'first in first out' rule. In the absence of contrary indication, a secured revolving facility may technically lose the security once an amount equal to the original loan and any associated charges and interest has been paid into the account, even though sums have been paid out in the meantime. This is rarely an issue in practice; however, as finance documents will be drafted to provide for inverse order of payment and/or for security to be continuing notwithstanding any intermediate payments made as long as there is anything outstanding under the loan.

3.13 Are there particular documentary or execution requirements (notarisation, execution under power of attorney, counterparts, deeds)?

Execution requirements are predominantly set out in the company's constitutive documents and the CA. In addition, certain instruments are also statutorily required to be in writing or executed by deed. For example, a legal mortgage over land must be by deed. Certain statutory remedies (e.g. power to sell the mortgaged property, to insure the property, to appoint a receiver, etc.) given to mortgagees will also not be available unless the mortgage is by deed. Commonly, it is prudent in any event for securities to be executed by deed so that there is no issue of past consideration. It is worth noting that amendments to the CA in 2015 introduced provisions allowing for the execution of deeds without the use of a common seal, thereby making the execution of deeds less administratively burdensome for local companies.

Where it is envisaged that the execution of the security instrument be completed by virtual means, it is also good practice for it to be done in line with the principles set out in the English case *R (on the application of Mercury Tax Group and another) v HMRC*.

4 Financial Assistance

4.1 Are there prohibitions or restrictions on the ability of a company to guarantee and/or give security to support borrowings incurred to finance or refinance the direct or indirect acquisition of: (a) shares of the company; (b) shares of any company which directly or indirectly owns shares in the company; or (c) shares in a sister subsidiary?

S76 of the CA provides, *inter alia*, that a public company or a company whose holding company or ultimate holding company is a public company, shall not, whether directly or indirectly, give any financial assistance for the purpose of, or in connection with the acquisition by any person (whether before or at the same time as the giving of financial assistance) or proposed acquisition by any person, of shares in the company or in a holding company or ultimate holding company (as the case may be) of the company. The prohibition does not extend to sister subsidiary companies. The CA further provides that financial assistance for the acquisition of shares may be provided by means of a loan, the giving of a guarantee, the provision of security, the release of an obligation or the release of a debt or otherwise.

These provisions may therefore be triggered in the event of the giving of guarantees/securities or other accommodation which may directly or indirectly provide 'financial assistance' within the meaning of the CA. There are, however, whitewash provisions available under our laws, including short form whitewash procedures that would enable the company to effect a whitewash through, *inter alia*, board approval if doing so does not materially prejudice the interests of the company or its shareholders or the company's ability to pay its creditors, or the passing of shareholders' and directors' resolutions and lodgement of solvency statements and papers with ACRA without the need for public notification and objection period or court order. Where the company is unable to effect a short form whitewash, parties have to bear in mind that the need for public notification and objection period for a long form whitewash will mean that a timeframe of six to eight weeks (assuming no objections) may be required.

5 Syndicated Lending/Agency/Trustee/Transfers

5.1 Will your jurisdiction recognise the role of an agent or trustee and allow the agent or trustee (rather than each lender acting separately) to enforce the loan documentation and collateral security and to apply the proceeds from the collateral to the claims of all the lenders?

Yes, Singapore recognises the role of an agent and trustee and these roles are normally taken up by the lead bank to whom the borrower has granted the mandate to arrange the syndicated loan. An express trust will be created to ensure the desired consequences.

The creation of the trust must comply with the relevant formalities. For example, s7 of the Singapore Civil Law Act (Cap. 43) requires a trust in respect of immovable property to be manifested and proved in writing signed by the person who is able to declare such trust. In addition, a validly constituted express trust has to be certain as to intention of the settlor to create the trust, identity of the subject matter and identity of the beneficiaries. Provided the relevant mechanics are set out in the finance documents and the trust is properly constituted, the security trustee will be able to hold the security on trust for the syndicated lenders and will have the right to enforce the finance documents and collateral security, including applying the proceeds from the collateral to the claims of the syndicated lenders in accordance with the finance documents.

5.2 If an agent or trustee is not recognised in your jurisdiction, is an alternative mechanism available to achieve the effect referred to above which would allow one party to enforce claims on behalf of all the lenders so that individual lenders do not need to enforce their security separately?

This is not applicable. Please refer to question 5.1 above.

5.3 Assume a loan is made to a company organised under the laws of your jurisdiction and guaranteed by a guarantor organised under the laws of your jurisdiction. If such loan is transferred by Lender A to Lender B, are there any special requirements necessary to make the loan and guarantee enforceable by Lender B?

The right of Lender B to enforce the loan and guarantee exists provided the procedure for assignment or novation of Lender A's rights and obligations, as set out in the finance documents, are complied with (e.g. consent of borrower and guarantor if required) and the continuity of the guarantee is provided for expressly and preserved under the documents.

Where there are no proper procedures or transfer/preservation provisions within the finance documents or the security agency/trust is not properly constituted, an assignment or novation of the underlying loan may result in an assigned or new debt which is not covered by the guarantee. A transfer in such a situation may fail and the guarantee rendered unenforceable over the assigned or new debt. In such an instance, a fresh guarantee will be required for Lender B to be guaranteed. In practice, confirmation by the guarantor is often sought even if the documents provide expressly for preservation without consent.

6 Withholding, Stamp and Other Taxes; Notarial and Other Costs

6.1 Are there any requirements to deduct or withhold tax from (a) interest payable on loans made to domestic or foreign lenders, or (b) the proceeds of a claim under a guarantee or the proceeds of enforcing security?

Withholding tax is applicable by virtue of s12(6) read with s45 or s45A of the Singapore Income Tax Act (Cap. 134) (***ITA***) where a person is liable to pay another person not known to him to be resident in Singapore any interest, commission, fee or any other payment in connection with any loan or indebtedness or with any arrangement, management, guarantee, or service relating to any loan or indebtedness if such payments are borne, directly or indirectly, by a person resident in Singapore or a Singapore permanent establishment or is deductible against any income accruing in or derived from Singapore. Interest and payments in connection with any guarantee or indebtedness that are made to foreign lenders would generally be subject to this withholding tax unless otherwise exempted. The current withholding tax rate on such s12(6) payments is 15% of the gross amount.

There are, however, various exceptions to this. S12(6A) of the ITA excludes from the scope of s12(6) the following payments:

(i) any payment made to a non-resident person for any arrangement, management or service relating to any loan or indebtedness where the arrangement, management or service is performed outside of Singapore for or on behalf of a person resident in Singapore or a permanent establishment in Singapore; and

(ii) any payment made to a guarantor who is a non-resident person for any guarantee relating to any loan or indebtedness.

For the purposes of s12(6A), a qualifying "non-resident" is one who does not by himself or in association with others, carry on a business in Singapore and does not have a permanent establishment in Singapore; or if he does carry on a business in Singapore (by himself or in association with others) or has a permanent establishment in Singapore, the arrangement, management, service or giving of guarantee was not performed or effectively connected through that business carried on in Singapore or that permanent establishment.

Since payments covered under s12(6A) are excluded from the scope of s12(6), the obligation to withhold tax does not arise for s12(6A) payments even though they are made to a non-resident person. In addition, s45(9)(c) exempts from withholding tax interest that is paid to Singapore branches of non-resident foreign companies (e.g. non-resident foreign banks). If the non-resident bank is a resident of country with which Singapore has an applicable tax treaty, the Avoidance of Double Taxation Agreement may provide for a different/reduced tax rate.

6.2 What tax incentives or other incentives are provided preferentially to foreign lenders? What taxes apply to foreign lenders with respect to their loans, mortgages or other security documents, either for the purposes of effectiveness or registration?

Singapore has various governmental agencies to assist foreign investors and creditors. The Economic Development Board is the lead governmental agency responsible for planning and executing strategies to attract foreign businesses and investments. International Enterprise Singapore works to position Singapore as a base for foreign businesses to expand into the region, in partnership with Singapore-based companies.

Although incentives are generally industry-specific, and not affected by the residency of the investors or creditors, there are selected schemes directed to attract foreign investors and creditors. For example, Singapore allows for reduced withholding tax rate on interest payments on loans taken to purchase productive equipment for the purposes of trade or business.

Save for withholding taxes as discussed in question 6.1, no taxes specific to loans, mortgages or other security documents, either for the purposes of effectiveness or registration, are applicable. Stamp duty as discussed in question 3.9 will be applicable.

6.3 Will any income of a foreign lender become taxable in your jurisdiction solely because of a loan to, or guarantee and/or grant of, security from a company in your jurisdiction?

Where the bank is not a tax resident in Singapore, withholding tax as discussed in question 6.1 may apply.

Where the bank is a tax resident in Singapore or has a branch in Singapore, any interest, commission, fee or any other payment in connection with any loan or indebtedness or with any arrangement, management, guarantee, or service relating to any loan or indebtedness that is borne, directly or indirectly, by a person resident in Singapore or a Singapore permanent establishment or is deductible against any income accruing in or derived from Singapore, that accrues to or is derived by the bank or its Singapore branch will be deemed to be sourced in Singapore and subject to income tax in Singapore by virtue of s12(6) read with s10(1) of the ITA.

6.4 Will there be any other significant costs which would be incurred by foreign lenders in the grant of such loan/guarantee/security, such as notarial fees, etc.?

Apart from fees and tax payable as discussed above (i.e. questions 3.9 and 6.1), the provision of certain services, for example the provision of guarantee services, may be subject to goods and services tax (***GST***) in Singapore if the provider of the service is registered for GST purposes pursuant to the Singapore Goods and Services Tax Act (Cap. 117A) unless the service qualifies as an international service or is an exempt supply on which no GST is chargeable. The rate at which GST is chargeable on standard-rated supplies of goods and services is presently 7%. During his 2018 Budget speech, Singapore Finance Minister Heng Swee Keat announced a planned GST hike of two percentage points, to 9%, sometime in the period from 2021 to 2025. He confirmed the increase in his Budget 2019 speech but said its exact timing was yet to be determined.

6.5 Are there any adverse consequences for a company that is a borrower (such as under thin capitalisation principles) if some or all of the lenders are organised under the laws of a jurisdiction other than your own? Please disregard withholding tax concerns for purposes of this question.

Thin capitalisation principles are not applicable in Singapore. However, it should be noted that should the banks be organised under the laws of a foreign jurisdiction, and no express choice of law is made in the finance documents, the applicable law for the finance documents may be that of the foreign jurisdiction. In such a situation, the borrower may not be able to enjoy the rights and remedies available to a borrower in Singapore, but not in that foreign jurisdiction.

7 Judicial Enforcement

7.1 Will the courts in your jurisdiction recognise a governing law in a contract that is the law of another jurisdiction (a "foreign governing law")? Will courts in your jurisdiction enforce a contract that has a foreign governing law?

Provided that it is *bona fide* and legal and there is no reason for avoiding the choice on the grounds of public policy, the express choice of the laws made by the parties to a contract will be upheld as valid and binding in any action in the courts of Singapore and the courts will enforce a contract that has a foreign governing law.

In January 2015, the Singapore International Commercial Court (***SICC***) was established to hear international commercial disputes, including those governed by foreign laws.

The key features of the SICC are: (i) it is a division of the Singapore High Court. This means that SICC judgments can be enforced as judgments of the Supreme Court of Singapore; (ii) it has a diverse panel of judges that will include eminent international jurists and existing Supreme Court Judges; (iii) its proceedings are open court proceedings although parties may apply for the proceedings to be confidential; and (iv) there is flexibility for parties to seek leave of court to apply alternative rules of evidence (i.e. rules which differ from the existing Singapore rules of evidence) which they may be more familiar with; and to appoint foreign-qualified lawyers to represent them in court where the cases have no substantial connection to Singapore or to address the Court on matters of foreign law.

In its first three years since 2015, the SICC heard a number of cases on a range of subjects and involving parties from various jurisdictions.

7.2 Will the courts in your jurisdiction recognise and enforce a judgment given against a company in New York courts or English courts (a "foreign judgment") without re-examination of the merits of the case?

A final judgment for a sum of money obtained against a company in Singapore (which is not a judgment for the payment of a fine, penalty or tax, or anything of that nature) in a superior court in England will be enforceable against the company in Singapore subject to the provisions of the Singapore Reciprocal Enforcement of Commonwealth Judgments Act (Cap. 264) (***RECJA***), without re-examination of the merits.

In 2016, Singapore also introduced the Choice of Court Agreements Act 2016 (***CCAA***), which implements the regime created by the 2005 Hague Convention on Choice of Court Agreements (***Hague Convention***). The CCAA applies to judgments given by courts of states that are parties to the Hague Convention. These states currently comprise all of the EU Member States (including England), Montenegro and Mexico. The United States of America, People's Republic of China and Ukraine have also signed the Hague Convention and it is pending their ratification. Under the CCAA, where parties have entered into an agreement designating the English courts as having exclusive jurisdiction in respect of a particular matter, and an English court renders a judgment in that matter, the English judgment may be recognised and enforced in Singapore without re-examination of the merits. This is subject to certain exceptions. For example, certain types of matters are excluded from the scope of the CCAA, such as insolvency matters and matters involving consumers. Recognition and enforcement may, depending on the court's discretion, be refused if, for example, where the English judgment is inconsistent with a Singapore judgment given in a dispute between the same parties. On the other hand, there are several grounds on which recognition and enforcement must be refused if, for instance, the foreign judgment was obtained by fraud in connection with a matter of procedure, or where it would be manifestly incompatible with the public policy of Singapore.

A final judgment for a sum of money obtained against a company in Singapore (which is not a judgment for the payment of a fine, penalty or tax, or anything of that nature) issued by New York courts will be enforced in Singapore in accordance with the common law. This is because there is no reciprocal agreement or convention between Singapore and the United States of America in respect of the enforcement of court judgments. Under the common law, a money judgment may be enforced, provided it is final and conclusive, and the foreign court had jurisdiction over the defendant in accordance with conflict principles recognised by the Singapore courts. It will then be for the defendant to prove that the New York courts had no jurisdiction over the matter, or that the judgment was obtained by fraud, or that there were any major procedural irregularities in arriving at the judgment, or that enforcement would be a direct or indirect enforcement of foreign penal, revenue or other public law, or that enforcement would be contrary to the public policy of Singapore. The Singapore court will not re-examine the merits of the case.

7.3 Assuming a company is in payment default under a loan agreement or a guarantee agreement and has no legal defence to payment, approximately how long would it take for a foreign lender to (a) assuming the answer to question 7.1 is yes, file a suit against the company in a court in your jurisdiction, obtain a judgment, and enforce the judgment against the assets of the company, and (b) assuming the answer to question 7.2 is yes, enforce a foreign judgment in a court in your jurisdiction against the assets of the company?

The timeline for each case would depend on its own facts. Generally, if the claim is against a defendant in Singapore and based on a straightforward loan agreement or guarantee, it is possible to obtain default or summary judgment within three to six months of filing the claim (assuming there is no appeal).

There are generally four main methods of enforcement, namely, a writ of seizure and sale, garnishee proceedings, examination of judgment debtor and bankruptcy proceedings. Depending on which method of enforcement is selected and whether any challenge is mounted by the debtor, the process could take two to six months or longer.

In May 2017, the Companies (Amendment) Act 2017 (***Amendments***) came into effect. Modelled on chapter 15 of the U.S. Bankruptcy Code, and the UK Cross-Border Insolvency Regulations, the Amendments adopted the UNCITRAL Model Law on Cross-Border Insolvency to allow foreign insolvencies to be more easily recognised in Singapore.

7.4 With respect to enforcing collateral security, are there any significant restrictions which may impact the timing and value of enforcement, such as (a) a requirement for a public auction, or (b) regulatory consents?

There is no specific requirement for a public auction, although sale by public auction is commonly carried out as a matter of practice. Secured creditors typically have wide powers under the terms of the security document to take possession, dispose or otherwise deal with the secured assets, or appoint a receiver in respect of the secured assets, to satisfy the secured debts. There may be requirements for regulatory consent in respect of certain types of borrower (for example, where it is a regulated entity).

7.5 Do restrictions apply to foreign lenders in the event of (a) filing suit against a company in your jurisdiction, or (b) foreclosure on collateral security?

There are no specific restrictions on foreign lenders filing a suit or foreclosing on collateral security so long as the Singapore courts have jurisdiction over the matter.

7.6 Do the bankruptcy, reorganisation or similar laws in your jurisdiction provide for any kind of moratorium on enforcement of lender claims? If so, does the moratorium apply to the enforcement of collateral security?

The CA provides for an automatic moratorium where a provisional liquidation or liquidation order is made. Notwithstanding the moratorium, secured creditors may enforce their security in a provisional liquidation or liquidation.

The CA also provides for an automatic moratorium upon the making of an application for a judicial management order, and upon the making of a judicial management order. However, in these situations, a creditor may not enforce any security over the company's assets without permission from the court or the judicial manager.

The court may also grant a moratorium order if requested by an applicant proposing or intending to propose a scheme of arrangement. Generally, a temporary stay of proceedings does not restrict the enforcement of collateral security granted by the applicant. However, the Amendments give the court express power to also restrain the enforcement of security over the property of the applicant or any of its related companies.

The Amendments introduced an automatic 30-day stay that comes into effect on the filing of an application for a moratorium order when proposing a scheme of arrangement. The Amendments also allow the moratorium to have worldwide or extraterritorial effect, if creditors are subject to the jurisdiction of the Singapore court.

7.7 Will the courts in your jurisdiction recognise and enforce an arbitral award given against the company without re-examination of the merits?

Arbitral awards may be recognised and enforced in Singapore in accordance with the New York Convention or under the Singapore Arbitration Act (Cap. 10) without having its merits re-examined. However, the courts may refuse to enforce such awards on the following grounds: incapacity of a party; failure to give proper notice to a party or the inability of a party to present his/her case; issues with the selection of the arbitrators; the award falling outside of the scope of the arbitration agreement; invalidity of the arbitration agreement; subject-matter of the difference between the parties to the award is not capable of settlement by arbitration under the law of Singapore; the award having been set aside; and/or the enforcement of the award being contrary to the public policy of Singapore.

8 Bankruptcy Proceedings

8.1 How does a bankruptcy proceeding in respect of a company affect the ability of a lender to enforce its rights as a secured party over the collateral security?

Bankruptcy proceedings in respect of a company include receivership, winding up, schemes of arrangement and judicial management. The right to appoint a receiver over a company can arise statutorily, contractually in accordance with the terms of the security document such as a debenture or by an exercise by the court of its power to appoint a receiver on the application of the secured creditor. In such a case, the receiver would act in furtherance of the interests of the secured creditor that appointed the receiver to realise the collateral security. For restrictions on enforcing security in the context of liquidation, schemes of arrangement and judicial management, see question 7.6 above.

8.2 Are there any preference periods, clawback rights or other preferential creditors' rights (e.g., tax debts, employees' claims) with respect to the security?

Yes. Liquidators and judicial managers, but not receivers, can apply to set aside or clawback certain transactions entered into before commencement of winding up. Such transactions include transactions at an undervalue, preferences, extortionate credit transactions, avoidance of floating charges and unregistered charges and transactions defrauding creditors. The clawback period ranges from five years (transactions at an undervalue) to three years (extortionate credit transactions) to six months (preferences) from the commencement of winding up. Generally, floating charges created within six months of the commencement of winding up are invalid except to the amount of any cash paid to the company in consideration of the charge together with interest, unless there is proof that the company was solvent at the time the floating charge was created.

The CA also contains provisions against fraudulent trading, i.e. where the business of a company has been carried on with the intent to defraud creditors or for any fraudulent purpose. A liquidator can in such an instance apply for a declaration for the person/director to be personally responsible for the debts/liabilities of the company.

The tax authorities and employees who are owed wages (up to a certain limit) are preferential creditors and are paid ahead of unsecured creditors but behind secured creditors.

8.3 Are there any entities that are excluded from bankruptcy proceedings and, if so, what is the applicable legislation?

Entities incorporated in Singapore are generally not excluded from bankruptcy proceedings in Singapore.

8.4 Are there any processes other than court proceedings that are available to a creditor to seize the assets of a company in an enforcement?

See question 8.1 above. In addition, creditors may apply for a writ of seizure or to garnish the assets of the debtor.

9 Jurisdiction and Waiver of Immunity

9.1 Is a party's submission to a foreign jurisdiction legally binding and enforceable under the laws of your jurisdiction?

Yes, a party's submission to a foreign jurisdiction will generally be upheld as valid and binding in any action in the courts of Singapore provided that it is *bona fide* and there is no reason for avoiding such submission on the grounds of illegality or public policy.

In particular, where a party has submitted exclusively to the jurisdiction of a state that is party to the Hague Convention, the

CCAA would apply and a Singapore court must stay or dismiss proceedings in the Singapore courts in favour of proceedings in the foreign court. This is subject to certain exceptions. For example, the CCAA does not apply to certain types of matters, such as insolvency matters and matters involving consumers. The Singapore court can also refuse to stay or dismiss proceedings in its courts if, for example, the agreement to submit to the foreign jurisdiction is null and void under the law of the foreign jurisdiction, or if giving effect to the agreement would lead to manifest injustice or would be manifestly contrary to the public policy of Singapore.

9.2 Is a party's waiver of sovereign immunity legally binding and enforceable under the laws of your jurisdiction?

A party's waiver of sovereign immunity may be legally binding and enforceable provided it satisfies the conditions as set out in the Singapore State Immunity Act (Cap. 313).

10 Licensing

10.1 What are the licensing and other eligibility requirements in your jurisdiction for lenders to a company in your jurisdiction, if any? Are these licensing and eligibility requirements different for a "foreign" lender (i.e. a lender that is not located in your jurisdiction)? In connection with any such requirements, is a distinction made under the laws of your jurisdiction between a lender that is a bank *versus* a lender that is a non-bank? If there are such requirements in your jurisdiction, what are the consequences for a lender that has not satisfied such requirements but has nonetheless made a loan to a company in your jurisdiction? What are the licensing and other eligibility requirements in your jurisdiction for an agent under a syndicated facility for lenders to a company in your jurisdiction?

Under Singapore law, unless exempted or excluded, a person may not carry on the business of a moneylender without holding the requisite moneylenders' licence. The relevant legislation, the Moneylenders Act (Cap. 188) (***MA***), provides that any person who lends a sum of money in consideration of a larger sum being repaid (i.e. charge interest), shall be presumed until the contrary is proved to be a moneylender. The same prohibition would apply to a "foreign" lender who carries on the business of moneylending in Singapore from a place outside Singapore.

"Any person licensed, approved, registered or otherwise regulated by the MAS under any other written law," amongst others, would fall outside the ambit of the prohibition as an "excluded moneylender". These would include banks or finance companies which are licensed and regulated under the Banking Act (Cap. 19) and Finance Companies Act (Cap. 108) respectively. The question therefore is whether "foreign" lenders or other non-bank entities that are not so licensed, approved, registered or otherwise regulated by the MAS are necessarily excluded. With effect from 1 March 2009, an amended Moneylenders Act came into force in Singapore pursuant to which, amongst others, "any person who lends money solely to corporations" or "any person who lends money solely to accredited investors within the meaning of section 4A of the Securities and Futures Act (Cap. 289)" would be an "excluded moneylender". Accordingly, a lender can be an "excluded moneylender" provided on the facts it lends (and has lent) money solely to corporations or only to accredited investors.

There has been academic debate on whether a "foreign" unlicensed lender or other non-bank entity would not be deemed to be an excluded moneylender if it had in the past lent money otherwise to individuals who were not accredited investors. The prevailing view, however, is that the Singapore courts are unlikely to allow such a defence without more to succeed in the context of legitimate financial activity of commercial entities.

Corporations convicted of unlicensed moneylending will be imposed a fine of not less than S$50,000 and not more than S$500,000. In addition, subject to certain exceptions, the contracts for such loans, and guarantees or securities given for such loans shall be unenforceable, and any money paid by or on behalf of the unlicensed moneylender under the contracts for the loans will not be recoverable in any court of law.

The granting of loans to corporations *per se* is not otherwise regulated in Singapore. There are no eligibility requirements in Singapore for a lender lending to a company and, subject to the above, it need not be licensed or authorised provided that no other regulated activities (e.g. banking, securities or financial advisory activities) are being conducted.

11 Other Matters

11.1 Are there any other material considerations which should be taken into account by lenders when participating in financings in your jurisdiction?

The principal Singapore law considerations for lenders when participating in financings in Singapore have generally been covered by the above questions and answers.

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1 Overview

1.1 What are the main trends/significant developments in the lending markets in your jurisdiction?

The lending market in Slovakia maintains its growing trend, while lending conditions continue to improve. This results from favourable national, as well as global, economic developments and prospects for the Slovak economy. So far, credit conditions have continued to ease; however, in the housing sector, the National Bank of Slovakia has intervened in order to protect the market from overheating. We can see growth in corporate and consumer lending, and financing is generally available under reasonable terms. Despite this, we can also see increased use of alternative methods of financing such as the issuance of corporate bonds. Furthermore, new methods of financing such as crowd funding and peer-to-peer funding are being explored. Increased regulation remains a topic, as well as the implications of Brexit.

1.2 What are some significant lending transactions that have taken place in your jurisdiction in recent years?

Several major real estate projects have been realised in recent years (either residential or office/shopping park projects). Furthermore, re-financing transactions have also been quite frequent due to favourable lending conditions.

To note some specific transactions: new high-rise downtown residential towers were financed by a bank syndicate; a new bus station in Bratislava, which is being developed by a private investor, obtained financing from a group of three banks; and a major €500m group re-financing was obtained by a regional company operating in the pharmaceutical/drug sector.

2 Guarantees

2.1 Can a company guarantee borrowings of one or more other members of its corporate group (see below for questions relating to fraudulent transfer/financial assistance)?

Intra-group company guarantees are generally not prohibited under Slovak law. However, in certain situations, limitations or potential consequences arising under capital maintenance rules/financial assistance regulation may be triggered (see the answers to question 2.2 and section 4 for more details).

2.2 Are there enforceability or other concerns (such as director liability) if only a disproportionately small (or no) benefit to the guaranteeing/securing company can be shown?

As of 1 January 2016, "company in crisis" regulation was introduced into the Slovak Commercial Code. It applies to limited liability companies, joint-stock companies, single joint stock companies and limited partnerships in which the general partner is not an individual. However, some specific institutions, such as banks, insurance companies, health insurance companies, asset management companies or the stock exchange, may not be considered as a company in crisis under this act.

A company is deemed to be in crisis when it is insolvent (within the meaning of the Insolvency Act) or at risk of becoming insolvent, which is the case if a company's equity (registered capital, reserve fund, other capital funds, etc.) to debt ratio is lower than 8/100.

The statutory body of a company in crisis is under a general duty of care and must take all steps that would normally be taken by a reasonably diligent person to overcome the crisis.

In addition to existing limitations on dividend payments, a company is prohibited to pay dividends if, given all circumstances, such payment would lead the company to crisis.

Additionally, loans and similar payments extended to a company in crisis by its statutory body (director), a proxy, a member of the supervisory board, a shareholder holding at least 5% of capital, or an associated person, are treated as equity under the special regime and any refund of such contributions by the company during the crisis is prohibited.

Further, when a security (guarantee, pledge, etc.) is provided by the above-mentioned persons to secure an obligation of a company in crisis, the company's creditor is entitled to be satisfied directly from such security, without the need to exercise its right against the company first (which would be the normal procedure). The above-mentioned persons may not be reimbursed for the provided security as long as the company remains in crisis or would become in crisis as a result.

A lender, which provided a company with a loan or similar payments during the company's crisis, until the declaration of the company's bankruptcy or the restructuring permit and at the time of the company's commitment knew or on the basis of the last published financial statement could have known of its crisis, is allowed to satisfy its claim from the company's asset secured under the abovementioned conditions only to the extent attributable to the difference between the amount of the receivable and the value of the security.

2.3 Is lack of corporate power an issue?

The Slovak law does not recognise the *ultra vires* doctrine. Any internal limitations of power of the management are not effective *vis-à-vis* third parties, and do not affect the validity of agreements. If the management exceeds such an internal limitation of the power, the company is bound by such an act. The liability of the management to the company is given and the company has the right to claim damages.

2.4 Are any governmental or other consents or filings, or other formalities (such as shareholder approval), required?

No governmental approvals or formalities are required. However, consent of the general meeting or the supervisory board, as the case may be, may be required if included in the constitutional documents of the respective company.

2.5 Are net worth, solvency or similar limitations imposed on the amount of a guarantee?

There are no such limitations imposed. However, for potential implications and triggering of company-in-crisis regulation, please see our response to question 2.2 above.

2.6 Are there any exchange control or similar obstacles to enforcement of a guarantee?

There are no exchange control or similar obstacles to enforcement of a guarantee under Slovak law.

3 Collateral Security

3.1 What types of collateral are available to secure lending obligations?

It is possible to take security over all the assets of a Slovak company. The most common types of security available in Slovakia are as follows:

- share pledge;
- pledge over receivables;
- account pledge;
- mortgage (pledge over real property);
- pledge over IP;
- pledge over undertaking; and
- notarial deed on direct enforceability.

Assignment of the title or transfer of title is also possible, but as a means of security is less frequently used in Slovakia. Therefore we have not elaborated on these instruments in detail.

3.2 Is it possible to give asset security by means of a general security agreement or is an agreement required in relation to each type of asset? Briefly, what is the procedure?

Slovak law does not recognise the concept of a floating charge or blanket lien. Each type of asset has to be charged individually and specified accordingly in the agreement. It would be possible to combine various types of assets into one agreement; however, that is not market practice and generally individual security agreements are concluded per each class of assets. The only exception is a share pledge agreement, which as standard also covers pledges over dividend payments connected with shares (which is basically a receivable). This is covered by one security agreement.

3.3 Can collateral security be taken over real property (land), plant, machinery and equipment? Briefly, what is the procedure?

Yes. All of the abovementioned assets can serve as security and are taken as standard collateral security. Slovak law differentiates between establishment of the security (in lending transactions, this would be conclusion of the security agreement) and creation of the security; creation is the subsequent perfection and registration in respective registers. The exception is the pledge over movable assets which are to be handed over to the pledgee. In such case, the pledge is created via a physical handover. However, in practice, such pledge is not used.

For security over real property, a security agreement in writing must be concluded. Slovak law does not set out any formal requirements for the agreement. However, sometimes lenders require that the signatures of the pledgors are verified by the notary. Pledge over real property (land, plants, buildings) is created via registration in the land registry. Please see the answers to questions 3.9 and 3.10 for more information about fees and timing.

For machinery and equipment, the procedure is similar. First, a security agreement shall be concluded which specifies the assets which shall serve as security (please note that future assets may also be subject to a pledge). Subsequently, the charge must be registered with the Notarial Central Register of Pledges. This can be done at any notarial office. Please note that for specific types of assets such as aircraft or naval vessels, etc., specific registers may exist where the charge shall be registered.

3.4 Can collateral security be taken over receivables? Briefly, what is the procedure? Are debtors required to be notified of the security?

Security over receivables is taken by way of a pledge over receivables. In the first place, parties must conclude a written pledge agreement. For creation of the pledge, registration in the Notarial Central Register of Pledges is required. Notification of the debtors is not required for perfection. However, it will not become effective *vis-à-vis* the debtors until creation of the pledge is notified to them; i.e. until such notification, debtors could validly pay the pledgor.

Security in the form of a security assignment is created by a security assignment agreement. No registration is required, but notification *vis-à-vis* the debtor is required in order for the agreement to be effective against debtor. This type of security is rarely used in Slovakia.

3.5 Can collateral security be taken over cash deposited in bank accounts? Briefly, what is the procedure?

Yes. Most commonly, this is done via an account pledge agreement. The procedure basically follows the same regime as the pledge over receivables. A written pledge agreement must be concluded and subsequently the pledge must be registered with the Notarial Central Register of Pledges.

3.6 Can collateral security be taken over shares in companies incorporated in your jurisdiction? Are the shares in certificated form? Can such security validly be granted under a New York or English law-governed document? Briefly, what is the procedure?

Security over shares may be taken via a share pledge agreement. The nature and form of shares depend on the type of company.

Limited liability company: Shares of Slovak limited liability companies are constituted by participation (ownership) interests, which are not deemed to be securities. Therefore, they are not in a certified form. Pledge over participation interests is created via conclusion of a written pledge agreement and registration of the pledge with the Commercial Register. Participation interest may not be subject to a pledge agreement if constitutional documents do not permit the transfer of a participation interest. If it may only be transferred with the general meeting's approval, its approval shall also be required for establishing a pledge on a participation interest. If, under the constitutional documents, the fulfilment of another condition is required for the transfer of a participation interest, the fulfilment of such condition is also required for establishing a pledge.

Joint stock company: Shares may be in the form of share certificates or dematerialised bearer shares, recorded with the Central Depository. For creation of the pledge for either type, a share pledge agreement must be in place. Pledge is created via registration of the pledge with the Register of Pledges, maintained by the Central Depository. If the articles of association condition the transferability of registered shares on the company's consent, then the company's consent is also required for establishing a pledge on such shares. If, under the articles of association, the fulfilment of another condition is required for the transfer of registered shares, the fulfilment of such condition is also required for establishing a pledge.

We are of the view that, legally speaking, New York or English law-governed pledge agreements are not *per se* prohibited and securities could be established under such documents. Nevertheless, certain registration requirements and mandatory provisions arising under conflict-of-law rules would need to be compliant with Slovak law. Therefore, this is hardly seen in Slovakia and, due to potential ambiguities and complications, it is not advisable.

3.7 Can security be taken over inventory? Briefly, what is the procedure?

Slovak law does not recognise the concept of a floating charge. Therefore, security over inventory may be ensured via pledge over movable assets of the company (existing as well as future). The process is the same as with machinery (please see our response to question 3.3 above).

3.8 Can a company grant a security interest in order to secure its obligations (i) as a borrower under a credit facility, and (ii) as a guarantor of the obligations of other borrowers and/or guarantors of obligations under a credit facility (see below for questions relating to the giving of guarantees and financial assistance)?

Subject to limitations and/or consequences described in questions 2.2 and 4.1, a company may secure both its own obligations as borrower, and as a guarantor of the obligations of other borrowers.

3.9 What are the notarisation, registration, stamp duty and other fees (whether related to property value or otherwise) in relation to security over different types of assets?

Slovak law does not impose any stamp duties in relation to security documents. Notarial fees and other registration fees are rather minor.

Fees for the notary for registration of the pledge in the Notarial Central Register of Pledges vary on the basis of the value of the secured obligation. However, the fee is capped at €182.57.

The fee for registration of a pledge (mortgage) with the land register is €66 (for standard proceedings where the land registry has 30 days to register the pledge) or €266 (for fast-track proceedings where the land registry makes the registration within 15 days).

For registration of the pledge over participation interest in a limited liability company with the Commercial Register, the fee amounts to €66.

3.10 Do the filing, notification or registration requirements in relation to security over different types of assets involve a significant amount of time or expense?

In general, filing, notification or registration requirements do not involve significant amounts of time or expense. The exception is registration of a mortgage, which may take up to 30 days. Otherwise, registration of pledges with the Notarial Central Register of Pledges is finalised and pledges are registered on the day of registration. The Commercial Register shall register the pledge within two business days. Registration of pledges with the land register shall take a maximum of 30 days.

3.11 Are any regulatory or similar consents required with respect to the creation of security?

There are no general regulatory consent requirements. Only registration requirements must be fulfilled for creation of the security. For the sake of completeness, the consent of the general meeting of a company may be required, if required under constitutional documents. In case of assets owned/managed by the state or municipality, further requirements may be imposed (e.g. approval by local councils, etc.).

3.12 If the borrowings to be secured are under a revolving credit facility, are there any special priority or other concerns?

No, there are not. Security can also be created with regard to future receivables.

3.13 Are there particular documentary or execution requirements (notarisation, execution under power of attorney, counterparts, deeds)?

There are no particular documentary or execution requirements. Slovak law does not require that the security documents be executed in the form of a notarial deed. Only with respect to share pledge agreements do the signatures of the parties require notarisation (i.e. persons executing the document must be verified and confirmed by notary, and a notarial stamp confirming the identity of persons signing the document is subsequently attached thereto). Documents may be executed under the power of attorney, which usually requires notarisation and apostille or legalisation, as the case may be. The number of counterparts is left for determination by the parties.

4 Financial Assistance

4.1 Are there prohibitions or restrictions on the ability of a company to guarantee and/or give security to support borrowings incurred to finance or refinance the direct or indirect acquisition of: (a) shares of the company; (b) shares of any company which directly or indirectly owns shares in the company; or (c) shares in a sister subsidiary?

(a) Shares of the company

A Slovak joint stock company may not advance funds, make loans or give security to acquire its shares by third parties. Any agreements entered in violation of such rules are invalid. This does not apply to ordinary business of banks or acquisition of shares by or for employees, provided that the equity is not below the registered capital and the reserve fund.

In addition, there is a general prohibition of acquisitions of own shares of the company, or giving security over own shares. Some exemptions apply here (e.g. mergers).

A Slovak limited liability company is not subject to explicit financial assistance rules. However, there is a direct liability of a company's shareholders (and directors) for any damage caused to a company's creditors by its insolvency. This rule may therefore result in comparable self-limitations in some cases. In addition, a general equal treatment rule also applies for all shareholders.

(b) Shares of any company which directly or indirectly owns shares in the company

In case of a joint stock company, the financial assistance rules also apply to the parent company in respect of acquisition of and/or securing shares of the subsidiary company. The Commercial Code defines a parent company in relation to its subsidiary company if, in general, it holds more than 50% shares or voting rights. The accounting or other laws may give an autonomous meaning to the parent company.

In case of a limited liability company, there are no such explicit rules. However, limitations described in (a) above may be relevant.

(c) Shares in a sister subsidiary

There are no explicit rules or case law regarding the acquisition of shares in sister subsidiaries (nor for a joint stock company or a limited liability company). General limitations, such as damage liability and equal treatment, may be relevant.

5 Syndicated Lending/Agency/Trustee/Transfers

5.1 Will your jurisdiction recognise the role of an agent or trustee and allow the agent or trustee (rather than each lender acting separately) to enforce the loan documentation and collateral security and to apply the proceeds from the collateral to the claims of all the lenders?

Even though the legal concept of a trustee or an agent is not recognised under Slovak law, lenders usually agree on a debt structuring and appoint a facility and/or security agent to represent them in all matters relating to finance and/or security documents. The scope of rights and obligations of the agent is a matter of commercial agreement and should be incorporated in the transaction documentation in detail.

5.2 If an agent or trustee is not recognised in your jurisdiction, is an alternative mechanism available to achieve the effect referred to above which would allow one party to enforce claims on behalf of all the lenders so that individual lenders do not need to enforce their security separately?

Please see the response to question 5.1 above.

5.3 Assume a loan is made to a company organised under the laws of your jurisdiction and guaranteed by a guarantor organised under the laws of your jurisdiction. If such loan is transferred by Lender A to Lender B, are there any special requirements necessary to make the loan and guarantee enforceable by Lender B?

Loans are usually transferred by assignment or novation.

To perfect the assignment of loan, the borrower/debtor must be notified thereof. Until the notification, the debtor may pay to the original lender. Consent of the borrower/debtor is not required unless agreed otherwise.

All security rights, including a guarantee (which is generally considered an accessory claim), are automatically transferred by the time of assignment of the loan. The initial/original lender shall inform the guarantor (or party providing the security) of the assignment without undue delay in order to avoid the risk of fulfilling its guarantee to the initial/original lender. The change on the lender's side should be registered in respective securities registers (kept by notary, cadastral office, etc.).

In a novation, a new loan is created and agreement of all parties thereto is required. The securities shall secure the new loan automatically. However, if the guarantor or pledgors do not agree with the novation, then the existing collaterals continue to secure the novated claim only to the extent of the originally secured obligation.

6 Withholding, Stamp and Other Taxes; Notarial and Other Costs

6.1 Are there any requirements to deduct or withhold tax from (a) interest payable on loans made to domestic or foreign lenders, or (b) the proceeds of a claim under a guarantee or the proceeds of enforcing security?

Withholding tax applies on foreign lenders in Slovakia. Generally, interest paid by a Slovak tax resident to a Slovak tax non-resident is subject to withholding tax of 19%. However, interest payable to a resident of a country not specified in the so-called "white list" (the list published by the Slovak Ministry of Finance or a country with which Slovakia has not entered into a double tax treaty, or agreement on the exchange of information relating to taxes) is subject to a 35% tax rate. Tax exemption is applicable on interest payable to a non-resident, in accordance with the EU Directive on the common system of taxation applicable to interest and royalty payments.

Under certain circumstances, the other proceeds of a claim may also be subject to the withholding tax in Slovakia. The other proceeds do not have a statutory meaning. Therefore, all relevant aspects must be taken into account, especially if the other proceeds may be viewed as income similar to the interest.

6.2 What tax incentives or other incentives are provided preferentially to foreign lenders? What taxes apply to foreign lenders with respect to their loans, mortgages or other security documents, either for the purposes of effectiveness or registration?

No Slovak tax or other incentives are provided preferentially to foreign lenders. No taxes (such as stamp, issue, registration or similar taxes or duties) apply with respect to loan, mortgages or other security documents for the purpose of effectiveness or registration.

6.3 Will any income of a foreign lender become taxable in your jurisdiction solely because of a loan to, or guarantee and/or grant of, security from a company in your jurisdiction?

Income of a foreign lender will not become taxable in Slovakia solely because of a loan to or guarantee and/or, generally, the grant of security from a company in Slovakia, as long as they do not have a permanent establishment in Slovakia which is effectively connected to the proceeds of the loan, guarantee or security interest.

6.4 Will there be any other significant costs which would be incurred by foreign lenders in the grant of such loan/guarantee/security, such as notarial fees, etc.?

No. Please see the answer to question 3.9 above.

6.5 Are there any adverse consequences for a company that is a borrower (such as under thin capitalisation principles) if some or all of the lenders are organised under the laws of a jurisdiction other than your own? Please disregard withholding tax concerns for purposes of this question.

Interest and related costs on borrowings and loans provided by related parties are tax-deductible at no more than 25% of adjusted EBITDA (the total of the result of operations before tax, including depreciation charges and the interest expense).

Transfer pricing rules (which may require notification to the tax authority and preparation of transfer pricing documentation) apply to borrowings from foreign-affiliated lenders.

7 Judicial Enforcement

7.1 Will the courts in your jurisdiction recognise a governing law in a contract that is the law of another jurisdiction (a "foreign governing law")? Will courts in your jurisdiction enforce a contract that has a foreign governing law?

In general, yes, the courts will recognise a foreign governing law. Regulation (EC) 593/2008 on the Law applicable to Contractual Obligations (Rome I) is directly applicable in Slovakia and parties are free to choose a governing law.

Therefore, subject to standard conflict-of-law rules such as overriding mandatory principles, public policy etc., the courts in Slovakia will enforce a contract governed by the foreign law.

7.2 Will the courts in your jurisdiction recognise and enforce a judgment given against a company in New York courts or English courts (a "foreign judgment") without re-examination of the merits of the case?

In principle, yes. However, one should distinguish whether the foreign judgment was rendered by an EU Member State or a non-EU Member State.

With respect to EU Member States, European regulation Brussels I is directly applicable and the Slovak courts should not re-examine the merits of the case.

As for foreign judgments rendered in non-EU Member States, such judgments may be refused only on limited grounds stated under the Act on Conflict of Laws or bilateral/international conventions. The decisions will be recognised and enforceable without re-examination if:

a) Slovak courts do not have exclusive jurisdiction to decide the case;

b) the decision is valid and effective (no further appeals available);

c) the decision deals with the merits of the case (i.e. no preliminary decisions or dealing only with particular questions);

d) the party's rights to a fair trial were not violated by the foreign body during the proceedings;

e) the Slovak court did not render a valid and effective decision on the merits of the case or there is no former foreign decision which was already recognised; or

f) it is not in contradiction with Slovak public order (*ordre public*).

7.3 Assuming a company is in payment default under a loan agreement or a guarantee agreement and has no legal defence to payment, approximately how long would it take for a foreign lender to (a) assuming the answer to question 7.1 is yes, file a suit against the company in a court in your jurisdiction, obtain a judgment, and enforce the judgment against the assets of the company, and (b) assuming the answer to question 7.2 is yes, enforce a foreign judgment in a court in your jurisdiction against the assets of the company?

It is difficult to assess, as there are various aspects and factors such as workload of the courts, complexity of the case, etc., which would influence the duration.

In simple matters with respect to (a), it may be up to one-and-a-half years. With respect to (b), the enforcement proceeding, if not contested, may take up to six months depending on the type of assets and cooperation of the company.

However, the timing may be substantially longer.

Please note that in lending transactions in Slovakia, lenders require, as collateral, a notarial deed on direct enforceability. If such document is executed, then lenders are not required to go to court in order to obtain an enforcement title. Rather, they may proceed with enforcement on the basis of the notarial deed. Furthermore, for enforcement of security in a form of a pledge, one does not need to go to a court to obtain any judicial decision but may initiate enforcement of the pledge out of court directly.

7.4 With respect to enforcing collateral security, are there any significant restrictions which may impact the timing and value of enforcement, such as (a) a requirement for a public auction, or (b) regulatory consents?

Slovak law allows for out-of-court enforcement of collateral security in the form of pledges. There are no significant restrictions and no judicial document is required in order to proceed with such enforcement. The condition for such enforcement is notification about commencement of the enforcement and its registration with respective registers, as the case may be. After such notification, at least 30 days need to lapse before actual commencement of the enforcement of the pledge.

Parties are free to agree on the method of enforcement, i.e. direct sale is allowed and the asset does not have to be sold via public auction. Nevertheless, public auction is a standard method of enforcement in Slovakia, and frequently used.

7.5 Do restrictions apply to foreign lenders in the event of (a) filing suit against a company in your jurisdiction, or (b) foreclosure on collateral security?

In general no, no distinction is made between domestic and foreign lenders.

7.6 Do the bankruptcy, reorganisation or similar laws in your jurisdiction provide for any kind of moratorium on enforcement of lender claims? If so, does the moratorium apply to the enforcement of collateral security?

The commencement of bankruptcy proceedings triggers automatic stay of enforcement with respect to lender claims and collateral security. Enforcement proceedings that have already been initiated shall be suspended, too. This does not apply to enforcement of account pledge or enforcement of pledge over transferable securities and enforcement via voluntary public auction.

7.7 Will the courts in your jurisdiction recognise and enforce an arbitral award given against the company without re-examination of the merits?

Under Slovak law, an arbitral award is deemed to have the same effects as the judgment of the court.

Slovakia is a party to the New York Convention on Arbitration of 1958. Slovak courts shall not re-examine the merits of the case. However, there are certain grounds for which the recognition and enforcement may be refused (e.g. the arbitration agreement is not valid, irregularities with composition of the tribunal, etc.). An award would not be recognised if the subject matter cannot be settled by arbitration in Slovakia or if the award goes against public policy.

8 Bankruptcy Proceedings

8.1 How does a bankruptcy proceeding in respect of a company affect the ability of a lender to enforce its rights as a secured party over the collateral security?

Please see the response to question 7.6. Commencement of bankruptcy proceedings triggers automatic stay of enforcement proceedings.

8.2 Are there any preference periods, clawback rights or other preferential creditors' rights (e.g., tax debts, employees' claims) with respect to the security?

The insolvency administrator or creditor may contest legal actions of the insolvent party subject to certain statutory requirements. Such clawback right shall be applied at the latest within one year from commencement of the bankruptcy proceedings, otherwise it ceases to exist. Time spans depend on the nature and ground of challenge.

The insolvency administrator may challenge legal actions on the following grounds: i) the legal action was without adequate consideration; ii) the legal action was beneficial only to one creditor; iii) the challenged legal action is "shortening" other creditors; and iv) legal action was taken after the bankruptcy proceedings.

The insolvency administration may challenge legal actions on the grounds under i) and ii) if the legal action occurred one year (three years in case of related parties transactions) prior to commencement of the bankruptcy proceedings. The insolvency administration may challenge legal actions which occurred up to five years prior to commencement of the bankruptcy on the grounds under iii). It is also possible to challenge legal actions under iv), if the bankruptcy against the insolvent party was declared within six month from the cancellation of the previous bankruptcy proceeding.

8.3 Are there any entities that are excluded from bankruptcy proceedings and, if so, what is the applicable legislation?

Certain entities governed by public law, such as state, state entities, municipalities, etc. are excluded from the application of Slovak bankruptcy law.

8.4 Are there any processes other than court proceedings that are available to a creditor to seize the assets of a company in an enforcement?

Pledges may be enforced without initiating any court proceedings directly by the creditor(s). In such case, the creditor is acting on behalf of the borrower and enforces the pledge via an agreed method of enforcement contained in the pledge agreement (e.g. direct sale, public auction, etc.). Notarial deed on direct enforceability is an enforcement title as well, and the creditor does not need to go to court in order to enforce its claim.

9 Jurisdiction and Waiver of Immunity

9.1 Is a party's submission to a foreign jurisdiction legally binding and enforceable under the laws of your jurisdiction?

In general, yes. Slovak courts will decline jurisdiction if parties agree that a foreign court is to have an exclusive jurisdiction. Slovak courts may, however, seize jurisdiction if, for example: i) Slovak courts should have exclusive jurisdiction, such as disputes relating to rights *in rem*; ii) employment, consumer or insurance contracts; iii) the defendant has already taken steps and initiated the proceedings with Slovak courts; or iv) if the Slovak courts would deem them to be an appropriate forum to hear the case.

9.2 Is a party's waiver of sovereign immunity legally binding and enforceable under the laws of your jurisdiction?

A waiver of sovereign immunity is generally legally binding, unless: (i) it conflicts with public international law; or (ii) covers areas that are specifically protected by international law.

10 Licensing

10.1 What are the licensing and other eligibility requirements in your jurisdiction for lenders to a company in your jurisdiction, if any? Are these licensing and eligibility requirements different for a "foreign" lender (i.e. a lender that is not located in your jurisdiction)? In connection with any such requirements, is a distinction made under the laws of your jurisdiction between a lender that is a bank *versus* a lender that is a non-bank? If there are such requirements in your jurisdiction, what are the consequences for a lender that has not satisfied such requirements but has nonetheless made a loan to a company in your jurisdiction? What are the licensing and other eligibility requirements in your jurisdiction for an agent under a syndicated facility for lenders to a company in your jurisdiction?

A banking licence will be required only if the lender conducts banking activities as defined under the Slovak Act on Banks or if other conditions set out under the Slovak Act on Banks are met. According to the Slovak Act on Banks, no person may provide, without a banking licence, loans or credits as part of its business or other activity by using repayable funds obtained from other persons on the basis of a public offer. Furthermore, consumer loans may be provided only under the special licence issued by the National Bank of Slovakia.

If the lender provides loans: i) in Slovakia; ii) on a continuous basis; iii) in its own name, at its own responsibility; and iv) with the aim to achieve profit, then a free trade licence may be required even if a banking licence would not be required (the activity would qualify as conducting business for which a trade licence is required).

A banking licence is not required for banks which obtained their banking licence in different EU Member States. Such lenders may passport their licence under EU regulation.

There are no different requirements for foreign lenders and local lenders. If the company provides loans without a licence, it may face fines or may commit a crime of unlawful undertaking. There are no eligibility requirements for an agent and, generally, such role does not trigger any licensing requirements.

11 Other Matters

11.1 Are there any other material considerations which should be taken into account by lenders when participating in financings in your jurisdiction?

Special and material considerations might be required depending on the structure and nature of the transaction. In any event, consultation with local counsel is recommended.

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Chapter 71

Slovenia


Andraž Jadek


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1 Overview

1.1 What are the main trends/significant developments in the lending markets in your jurisdiction?

Following the setback during the economic and financial crisis, the economic situation in Slovenia continued to improve in 2018. The value of the composite Economic Sentiment Indicator almost reached pre-2008 levels. The economic forecast for Slovenia is also optimistic. In November 2018, the European Commission forecasted that GDP growth in 2019 in Slovenia will be 3.3%.

Loans to domestic non-banking sectors in Slovenia continued to strengthen in 2018. On the other hand, the volume of corporate and NFI loans has been falling gradually. This is related to somewhat higher loan repayments, as the volume of newly extended loans increased slightly in late 2018 (source: *Slovenian Economic Mirror No 6/2018*, Institute of Macroeconomic Analysis and Development).

Continued uncertainty surrounding the details of Brexit may adversely affect the economic situation and increase volatility in lending markets in Slovenia.

2 Guarantees

2.1 Can a company guarantee borrowings of one or more other members of its corporate group (see below for questions relating to fraudulent transfer/financial assistance)?

The two most common forms of company in Slovenia are the limited liability company (*družba z omejeno odgovornostjo*) and the joint-stock corporation (*delniška družba*). While both company forms are regulated under the Companies Act, there are several differences regarding the rules that apply individually.

LLCs. Entering into a guarantee agreement by an LLC to guarantee borrowings of its subsidiary (i.e. downstream guarantee) is legally permissible and generally unproblematic. However, when providing guarantee for borrowings of its shareholders or their subsidiaries (i.e. upstream guarantee or cross-stream guarantee), an LLC must abide by the capital maintenance rules applicable under the Companies Act and receive appropriate consideration. According to the prevailing theory (referencing German legal theory), the entry into a guarantee agreement securing obligations of a shareholder can on its own breach the capital maintenance rules of an LLC (even before any payments are made through enforcement of security). The capital maintenance rules prohibit an LLC from making payments or other distributions of value to its shareholders from the assets required for preservation of its share capital and restricted capital reserves. The recipient of the prohibited capital distribution must be in bad faith. Financial institutions acting as lenders are held to a higher standard of diligence. As annual reports of LLCs are publicly available in Slovenia, a balance sheet test must be made to determine whether the value of the security (i.e. guarantee) exceeds the amount of free reserves available for distribution. If that amount was exceeded, the giving of such security is prohibited and the guarantee agreement would be null and void if the recipient was in bad faith.

Corporations. Slovenian capital maintenance rules are much stricter for corporations than LLCs. Under the Companies Act, any distribution of capital to shareholders outside the distribution of dividends is prohibited. This rule does not restrict corporations from giving downstream guarantees, which are legal and generally unproblematic. However, upstream and cross-stream guarantees made by corporations are generally prohibited in absolute terms. A notable exception that may apply is a guarantee made under an applicable group controlling agreement.

The above rules apply to guarantees and other forms of security agreements.

2.2 Are there enforceability or other concerns (such as director liability) if only a disproportionately small (or no) benefit to the guaranteeing/securing company can be shown?

Members of management and supervisory boards are jointly and severally liable to the company for damages arising from violation of their duties, unless they can demonstrate that they fulfilled their duties fairly and conscientiously. Therefore, when a guarantee is not made under arm's length terms and in violation of the capital maintenance rules described under question 2.1 above, this can be a ground for directors' liability. If, in order to implement the transaction, the controlling company, through its legal representatives or otherwise, used its controlling influence and caused the subsidiary to consent to a transaction that is harmful, this may generate a loss which the controlling company has to compensate unless a controlling agreement was in place. If the loss is not compensated during the financial year, this must be determined and appropriately reported and audited. Legal representatives of the controlling company may be held liable for all damages caused to the subsidiary if the loss from a harmful transaction which was induced upon the subsidiary was not timely compensated as provided under the Companies Act. Compensation claims of the subsidiary may also be pursued by its creditors if the subsidiary is unable to repay them.

Guarantees that breach capital maintenance rules are null and void and thus cannot be enforced by the lender.

2.3 Is lack of corporate power an issue?

Under the Companies Act, legal transactions entered into by a company with third parties which are beyond the scope of the company's activity laid down by its articles or memorandum of association (i.e. *ultra vires*) or beyond permitted transactions shall be valid unless a third party was aware or should have been aware of such fact. The indication of activities in articles or memorandum of association shall not mean that a third party was aware or should have been aware of this fact. Note that, in legal theory, this limitation is considered mainly as an internal limit of powers of the company's bodies. Therefore, in practice, the "awareness criterion" has limited relevance.

2.4 Are any governmental or other consents or filings, or other formalities (such as shareholder approval), required?

Executive directors do not need shareholder or any other approval to grant guarantees as this falls within their general corporate powers. That said, directors may avoid liability for damages arising from the grant of a guarantee if they acted based on a lawful shareholder resolution. Approval of the transaction by the management or supervisory board does not relieve the directors of their liability. This applies to both LLCs and corporations.

Insolvent companies may not grant guarantees and a debtor in a bankruptcy procedure requires consent of the court.

2.5 Are net worth, solvency or similar limitations imposed on the amount of a guarantee?

See the answers to questions 2.1 and 2.2 above.

2.6 Are there any exchange control or similar obstacles to enforcement of a guarantee?

There are presently no exchange or asset controls in Slovenia. As Slovenia is a member of the Economic and Monetary Union, any exchange controls are imposed by the European Central Bank. Regulation (EC) No 1889/2005 on controls of cash entering or leaving the Community imposes controls on cash and other securities. Other asset controls may be imposed on the basis of the Slovenian Prevention of Money Laundering and Terrorist Financing Act.

3 Collateral Security

3.1 What types of collateral are available to secure lending obligations?

Under Slovenian law, the following types of collateral are most commonly used:

Real estate

- mortgage; and
- maximum mortgage.

Motor and rail vehicles, equipment, inventory, and certain types of animals

- pledge (possessory or non-possessory by registration); and
- fiduciary transfer of title.

Other movables

- pledge (possessory or non-possessory); and
- fiduciary transfer of title.

Shares

- pledge; and
- fiduciary assignment.

Receivables

- pledge; and
- fiduciary assignment.

Cash account

- pledge; and
- fiduciary assignment.

Intellectual property

- pledge; and
- fiduciary assignment.

3.2 Is it possible to give asset security by means of a general security agreement or is an agreement required in relation to each type of asset? Briefly, what is the procedure?

Under Slovenian law, it is not possible to give security over assets by means of a general security agreement. The concept of a floating charge is not recognised and a separate security agreement normally needs to be entered into with regard to each individual asset class.

Note that a so-called general fiduciary assignment is possible with respect to fiduciary assignment of receivables, where security may be created over all existing and future receivables of an assignor and/or its legal relationships. A general fiduciary assignment is ordinarily entered into in the form of a written contract, even though no specific form is legally required. For the assignee to obtain the right to a separate settlement in insolvency of the assignor, the security agreement shall be concluded in the form of a notarial deed.

Similarly, a pledge over inventory has certain elements of general security, since the description of individual parts is not required to create security. Such collateral remains valid despite subsequent changes in inventory.

3.3 Can collateral security be taken over real property (land), plant, machinery and equipment? Briefly, what is the procedure?

Collateral security can be taken over real estate (land) and movables that do not constitute a fixture (including plant, machinery and equipment). Special regulation applies to collateral security over motor and rail vehicles, certain types of animals, ships, and aircraft.

Real estate. Security on real estate is a mortgage, which is an accessory security right. This means that it secures a specific secured obligation and ceases by operation of law when the secured obligation is repaid or otherwise terminates. The mortgage needs to be perfected by entry into the land register. The mortgage agreement shall be concluded in a written form with the signature of the pledger notarised. For the mortgage to be directly enforceable (i.e. enforceable without the need to initiate any legal action first), the mortgage agreement shall be entered into in the special form of a directly enforceable notarial deed.

Mortgages are often created in the form of a maximum mortgage where all existing and future claims arising from specific business relationships are secured by the same mortgage on real estate up to a specific secured amount. Maximum mortgages are most often used for securing revolving credit facilities. For the maximum mortgage to be directly enforceable, the mortgage agreement shall be entered into in the special form of a directly enforceable notarial deed. In addition, the outstanding amounts of secured obligations also have to be recognised in the form of a notarial deed.

Plant, machinery and equipment. Both non-possessory and possessory pledges can be created over these movables.

A non-possessory pledge is not valid without a security agreement in the form of a directly enforceable notarial deed. Non-possessory pledges over equipment, motor and rail vehicles, and certain animals (cattle and equines) can be registered in the public register in Slovenia. Such registration legally perfects the pledge and unique identifiers are assigned in the process. Registration has the effect of publicity against third persons, resulting in the presumption of bad faith with respect to registered collateral. Collateral is created at the time of an entry into the register. Registrations are normally done by notaries, but pledges may also be registered by enforcement officers, tax collectors, courts or other public authorities in certain instances. For fees, see question 3.9 below. A separate and specialised register also exists for non-possessory pledges on ships and aircraft. A similar regime applies for perfection of security over these two types of assets.

Possessory pledge is created when a pledger delivers the pledged movable into the direct possession of the pledgee or a third person such that only the pledgee can demand its delivery. Written form is required if out-of-court sale of the collateral was agreed; otherwise no special form is legally required for the establishment of a possessory pledge on a movable. However, it is recommended that the written form be used.

3.4 Can collateral security be taken over receivables? Briefly, what is the procedure? Are debtors required to be notified of the security?

Collateral security can be taken over receivables in the form of a pledge or fiduciary assignment.

Pledge. There is no special formal requirement for creation of a pledge on receivables, but normally a written pledge agreement is entered into. Notarisation is not required. The pledge is validly created once the debtor is notified of the pledge. Until such notification, the pledge does not legally exist.

Fiduciary assignment. Even though no special form is required, fiduciary assignment is at the minimum entered into in the form of a written contract. Note that for the assignee to obtain the right to separate settlement in insolvency of the assignor, the security agreement shall be concluded in the form of a notarial deed. Therefore, in practice, all fiduciary assignment agreements are concluded in such form.

Fiduciary assignment is valid upon execution of the contract. Neither confirmation nor notification of the debtor are prerequisites for perfection. However, note that a good faith debtor is entitled to discharge its debt to the assignor until he has been notified of the assignment. Notification to the debtor is therefore advisable.

Financial collateral agreements. Note that both Directive 2002/47/EC on financial collateral arrangements and the subsequently adopted Directive 2009/44/EU were transposed into Slovenian legislation with the Financial Collateral Act. The Financial Collateral Act applies to collateral agreements between certain participants in the financial market; *inter alia*, certain public bodies, central banks, credit institutions, insurance companies, investment funds, management companies, etc. The Financial Collateral Act also applies to collateral agreements between these participants on one hand and large, mid-sized and small companies on the other hand. The Financial Collateral Act regulates both pledges on and fiduciary assignments of financial instruments, cash and credit claims.

The following special rules apply:

- a maximum pledge can be created over financial instruments, cash and credit claims recorded in a register under the rules applicable to maximum mortgage;
- an out-of-court sale of the pledged financial instruments and credit claims is permitted without specific requirements or restrictions (such as prior notice, waiting period, public auction or consent);
- fiduciary assigned financial instruments, cash and credit claims may in case of default be retained, sold, and/or set-off by the lender;
- financial collateral agreements and rights arising from them (including enforcement and set-off rights) remain in full force and effect even after insolvency proceeding is initiated against the debtor; and
- conditions for challenging of financial collateral in insolvency are more restrictive.

3.5 Can collateral security be taken over cash deposited in bank accounts? Briefly, what is the procedure?

Collateral security in the form of a pledge or fiduciary assignment can be taken over cash deposited in bank accounts.

As a pledge or fiduciary assignment of deposited cash is a pledge or assignment of receivables, the general procedure as described in question 3.4 above applies. When applicable, specific regulation under the Financial Collateral Act applies, as described in question 3.4 above.

3.6 Can collateral security be taken over shares in companies incorporated in your jurisdiction? Are the shares in certificated form? Can such security validly be granted under a New York or English law governed document? Briefly, what is the procedure?

Collateral security can be taken over shares in companies incorporated in Slovenia in the form of a pledge or through fiduciary assignment. A pledge is the predominant type of security over shares used in Slovenia.

Neither business shares in LLCs nor shares in corporations are in certified form. While shares in LLCs do not legally constitute securities, corporations issue shares in dematerialised form which are registered in the securities registry administered by the Slovenian Securities Depository.

New York or English law may govern the respective pledge or fiduciary assignment over shares so long as mandatory provisions of Slovenian law governing the creation, perfection and enforcement of such collateral security are complied with.

LLCs. The pledge agreement must be concluded in the form of a notarial deed and the pledge must be entered into the court register. The same rules apply to fiduciary assignment.

Corporations. Pledges over shares in corporations are validly created and perfected by registration in the securities register. The pledge is registered based on the order of the titleholder. Pledged shares may not be disposed of without express permission of the pledgee, but the pledger retains the voting rights. All dividends and other payments belong and are paid to the pledgee, but the parties may agree that the profit distributions are passed to the pledger. The fiduciary assignment is created and perfected by the order to transfer the shares. For specific rules under the Financial Collateral Act, see question 3.4 above.

3.7 Can security be taken over inventory? Briefly, what is the procedure?

Collateral security can be taken over inventory in the form of a pledge or non-possessory pledge by registration. The same regime as described in question 3.3 above applies.

3.8 Can a company grant a security interest in order to secure its obligations (i) as a borrower under a credit facility, and (ii) as a guarantor of the obligations of other borrowers and/or guarantors of obligations under a credit facility (see below for questions relating to the giving of guarantees and financial assistance)?

Yes, subject to limitations described in questions 2.1 and 2.2 above.

3.9 What are the notarisation, registration, stamp duty and other fees (whether related to property value or otherwise) in relation to security over different types of assets?

There are no stamp duties or taxes applicable to creation or perfection of security over assets in Slovenia.

Both notary and court register fees apply for creation of collateral security.

A notary fee of up to EUR 1,000 applies for a security agreement concluded in the form of a notarial deed. The fee depends on the value of the secured obligations. In addition, a fee of EUR 0.50 per page of counterpart issued by the notary to the parties applies. Notaries are also entitled to reimbursement of actual costs or the lump-sum amount of 2% of the first EUR 459 and 1% of the excess, if the actual costs cannot be determined.

The following additional fees apply in relation to different types of collateral security:

<u>Security over real estate (mortgages)</u>. A filing fee of EUR 37 applies for each entry into the land register by a notary and a court fee of EUR 50 applies to each land register procedure. In addition, a fee of EUR 23 applies for each review of the land register before registration by the notary.

<u>Non-possessory pledges</u>. A registration fee of up to EUR 50 applies.

<u>Security over shares in LLC</u>. A fee of EUR 37 applies for each entry into the court register by a notary. A fee of EUR 23 applies for each review of the court register before registration by the notary.

<u>Security over intellectual property</u>. A fee of up to EUR 70 applies if security is created by registration in the intellectual property register.

3.10 Do the filing, notification or registration requirements in relation to security over different types of assets involve a significant amount of time or expense?

Regarding expenses, see question 3.9 above.

The registration of collateral security over real estate (mortgage) normally takes up to one month, provided that there are no unresolved entries and notices of pending actions in the land register on the applicable real estate. Any pending entries and notices can prolong the procedure substantially. Perfection of collateral security on shares normally takes up to one week and registration in the non-possessory register shall generally be concluded within two weeks.

3.11 Are any regulatory or similar consents required with respect to the creation of security?

No such regulatory consents are required in Slovenia.

3.12 If the borrowings to be secured are under a revolving credit facility, are there any special priority or other concerns?

There are no such special priority or other concerns in Slovenia.

With real estate, in most cases revolving credit facilities are secured by a maximum mortgage which secures all existing and future claims arising from a specific business relationship. For details, see question 3.3 above.

3.13 Are there particular documentary or execution requirements (notarisation, execution under power of attorney, counterparts, deeds)?

Regarding notarisation, see questions 3.3, 3.4 and 3.6 above.

Powers of attorney must be in the same form as security agreements (i.e. if the security agreement needs to be notarised, so does the power of attorney).

Foreign entities are entered into the land register as pledgees with a special Slovenian identification number which needs to be obtained in advance.

4 Financial Assistance

4.1 Are there prohibitions or restrictions on the ability of a company to guarantee and/or give security to support borrowings incurred to finance or refinance the direct or indirect acquisition of: (a) shares of the company; (b) shares of any company which directly or indirectly owns shares in the company; or (c) shares in a sister subsidiary?

(a) Shares of the company

<u>LLCs</u>. Apart from the obligation to comply with the capital maintenance rules (described in question 2.2 above), Slovenian law prescribes no further prohibitions or restrictions on the ability of an LLC to guarantee and/or give security to support borrowings incurred to finance or refinance the direct or indirect acquisition of its shares.

<u>Corporations</u>. Under the Companies Act, a legal transaction by which a corporation secures an advance payment or a loan for the acquisition of its shares or any other transaction with a comparable effect shall be null and void. According to the case law, giving a guarantee or providing collateral over its assets is considered a transaction with a comparable effect that is prohibited. Therefore, a guarantee and/or security to support borrowings incurred to finance or refinance the direct or indirect acquisition of shares in a corporation is null and void.

(b) Shares of any company which directly or indirectly owns shares in the company

Same as the answer to (a) above.

(c) Shares in a sister subsidiary

Same as the answer to (a) above.

5 Syndicated Lending/Agency/Trustee/Transfers

5.1 Will your jurisdiction recognise the role of an agent or trustee and allow the agent or trustee (rather than each lender acting separately) to enforce the loan documentation and collateral security and to apply the proceeds from the collateral to the claims of all the lenders?

The roles of agents and trustees as they are normally undertaken in syndicated lending transactions are not statutorily regulated as special legal concepts in Slovenia. Therefore, the parties cannot rely on a developed legal framework tailored for this purpose. That said, there are no rules that would prohibit or limit the contractual appointment of an agent or trustee to such roles and authorising them to enforce the loan documentation and collateral security and to apply the proceeds from the collateral to the claims of all lenders.

5.2 If an agent or trustee is not recognised in your jurisdiction, is an alternative mechanism available to achieve the effect referred to above which would allow one party to enforce claims on behalf of all the lenders so that individual lenders do not need to enforce their security separately?

While the concept of parallel debt is not explicitly regulated by Slovenian law, the view of the legal theory is that the creation of "quasi" parallel debt structures in Slovenia shall be permissible as an available alternative mechanism either by creation of joint and several claims or parallel collective claims of the agent or trustee. Since there is no authoritative case law on the validity of parallel debt arrangements, it is not possible to maintain that such structures would indeed be fully valid and enforceable in all respects. Lenders in general, therefore, avoid relying on parallel debt of the agents and arrange for creation, perfection and enforcement of security for their individual secured claims, whereby agents or trustees are appointed and authorised to act on behalf of all lenders in enforcement of their security as authorised representatives.

5.3 Assume a loan is made to a company organised under the laws of your jurisdiction and guaranteed by a guarantor organised under the laws of your jurisdiction. If such loan is transferred by Lender A to Lender B, are there any special requirements necessary to make the loan and guarantee enforceable by Lender B?

While neither confirmation by nor notification to the debtor or guarantor about the transfer of the loan receivables are prerequisites for perfection of such transfer, a debtor and the guarantor acting in good faith are entitled to discharge its debt to the original lender until he has been notified of the assignment.

Guarantees are accessory to loans and are automatically transferred to the assignee together with the assigned loan receivable. Therefore, no additional requirements other than notification as described above are necessary for the guarantee to be enforceable after the assignment.

Note that the transfer of the whole loan and/or guarantee agreement and relationship requires prior consent of the debtor and guarantor to be valid and enforceable. Such consent shall be given in the same form as the underlying agreement. Therefore, most loan and guarantee transfers are made through assignment.

6 Withholding, Stamp and Other Taxes; Notarial and Other Costs

6.1 Are there any requirements to deduct or withhold tax from (a) interest payable on loans made to domestic or foreign lenders, or (b) the proceeds of a claim under a guarantee or the proceeds of enforcing security?

Generally, the debtor is liable to deduct or withhold the tax from interest on loans when they are paid by a Slovenian tax resident or by a Slovenian permanent establishment of a foreign tax resident. Proceeds of a claim under a guarantee or the proceeds of enforcing security are subject to withholding tax, if they have the nature of interest. Interest shall comprise the income arising from all types of receivables, regardless of whether they are collateralised with a mortgage, and interest arising from all debt securities and other debt financial instruments, including premiums and bonuses belonging to such securities and financial instruments, other than interest for late payment. Under the Slovenian domestic law, tax at a rate of 15% shall be withheld when making the payment to a corporate taxpayer and at a rate of 25% for payments to individual taxpayers.

6.2 What tax incentives or other incentives are provided preferentially to foreign lenders? What taxes apply to foreign lenders with respect to their loans, mortgages or other security documents, either for the purposes of effectiveness or registration?

Tax exemption may apply (i) when the payment is made to a tax resident of Slovenia (corporate taxpayer) or to a Slovenian permanent establishment of a foreign tax resident (corporate taxpayer), (ii) when conditions under the EU Interest & Royalty Directive and/or under Double Tax Treaties are met, and (iii) if there are special regulations on withholding tax on interest arising from debt securities which have been issued by Slovenian business entities.

No taxes (such as stamp duty and similar) apply with respect to loans, mortgages, securities or other similar documents.

6.3 Will any income of a foreign lender become taxable in your jurisdiction solely because of a loan to, or guarantee and/or grant of, security from a company in your jurisdiction?

Income of a foreign lender shall not become taxable in Slovenia solely because of a loan to or guarantee and/or grant of security from a company in the Slovenian jurisdiction, provided that (i) the incomes are not related to the activities of a Slovenian permanent establishment of a foreign lender or the foreign lender is not a tax resident of Slovenia, and/or (ii) the incomes are not considered as Slovenian-source incomes.

6.4 Will there be any other significant costs which would be incurred by foreign lenders in the grant of such loan/guarantee/security, such as notarial fees, etc.?

Costs of foreign lenders generally will not differ significantly from costs of domestic lenders. See question 3.9 above on fees.

Additional costs to foreign lenders may arise due to the fact that all security documentation necessary for registration must be submitted to the Slovenian authorities in the Slovenian language. Notarial deeds are also entered into primarily in the Slovenian language. Costs of official translations may therefore apply.

6.5 Are there any adverse consequences for a company that is a borrower (such as under thin capitalisation principles) if some or all of the lenders are organised under the laws of a jurisdiction other than your own? Please disregard withholding tax concerns for purposes of this question.

No, generally there are no such adverse consequences under Slovenian law.

7 Judicial Enforcement

7.1 Will the courts in your jurisdiction recognise a governing law in a contract that is the law of another jurisdiction (a "foreign governing law")? Will courts in your jurisdiction enforce a contract that has a foreign governing law?

In Slovenia, the conflict of laws regime is governed by a directly applicable EU Regulation (EC) 593/2008 on the Law applicable to Contractual Obligations (Rome I Regulation), which accordingly also governs the choice of law rules. Subject to limitations set forth in Rome I Regulation, courts in Slovenia will therefore recognise and enforce contracts that have a foreign governing law.

7.2 Will the courts in your jurisdiction recognise and enforce a judgment given against a company in New York courts or English courts (a "foreign judgment") without re-examination of the merits of the case?

Judgments of courts of EU Member States (e.g. England, as of now). For these judgments, Regulation (EU) No 1215/2012 on jurisdiction and the recognition and enforcement of judgments in civil and commercial matters (recast) (Brussels I Regulation) shall apply.

Under Article 36 of Brussels I Regulation, a judgment of a court shall be recognised in other Member States without any special procedure. As for the enforcement, under Article 39 of Brussels I Regulation, a judgment of a court of an EU Member State, which is enforceable in that Member State, shall be enforceable in other Member States without a declaration of enforceability. That said, all the grounds for refusal or suspension of enforcement under the law of the Member State addressed shall generally apply (subject to certain exceptions from the Brussels I Regulation).

According to Brussels I Regulation, any interested party can apply for refusal of recognition or enforcement of a judgment of a court of an EU Member State. Such application can, however, be made on very limited grounds (e.g. based on arguments of public policy (*ordre public*), due process or irreconcilable judgments (*res iudicata*)).

Judgments of courts of non-EU countries (e.g. New York). For these judgments, the Slovenian Private International Law and Procedure Act shall apply. A special recognition procedure needs to be carried out to recognise such foreign judgments. The recognition procedure is very limited in scope, as the judgment will not be recognised only for explicitly quoted reasons (e.g. if the effect of recognition would run counter to the public order of Slovenia (*ordre public*), if exclusive jurisdiction over the matter involved lies with Slovenian courts or authorities, if a court or another authority of Slovenia rendered a final decision on the same matter, or if some other foreign judicial decision rendered on the same matter was recognised in Slovenia (*res iudicata*)). Slovenian courts will not re-examine the merits of the case outside the scope described.

7.3 Assuming a company is in payment default under a loan agreement or a guarantee agreement and has no legal defence to payment, approximately how long would it take for a foreign lender to (a) assuming the answer to question 7.1 is yes, file a suit against the company in a court in your jurisdiction, obtain a judgment, and enforce the judgment against the assets of the company, and (b) assuming the answer to question 7.2 is yes, enforce a foreign judgment in a court in your jurisdiction against the assets of the company?

The duration of obtaining and recognising judgments and enforcing them before Slovenian courts will depend on several factors, predominantly the workload of the courts and the complexity of the matter, as well as the country where the judgment was issued (for recognition and enforcement procedures).

Generally, it can be expected that a first-instance judgment will be issued in two to three years. In case of appeal, the proceedings are generally prolonged for additional two years. Enforcement of judgments issued by EU Member State courts shall generally be a matter of weeks, while the recognition and enforcement procedure regarding judgments from non-EU countries is usually a matter of months.

7.4 With respect to enforcing collateral security, are there any significant restrictions which may impact the timing and value of enforcement, such as (a) a requirement for a public auction, or (b) regulatory consents?

Note that the timing of judicial enforcement depends significantly on whether the security is established by a directly enforceable notarial deed. In that case, the lender does not need to initiate litigation proceedings before enforcing the security and is able to initiate judicial enforcement proceedings immediately. If security is not created by a directly enforceable notarial deed, several years can pass before Slovenian courts issue a final judgment that allows for judicial enforcement proceedings to begin.

Slovenian law provides for detailed rules on enforcement proceedings, both generally and specifically for different types of assets that are subject of enforcement proceedings. The court generally has a leading role in and conducts the proceedings, as well as issues orders to other entities involved (bailiffs, banks, appraisers, etc.). Enforcement proceedings depend on the type of security and collateral.

Enforcement on real estate. Such enforcement can be carried out via a court sale or an out of court sale via a notary.

In a court sale, real estate is first appraised and afterwards sold by the court in an auction or by collecting binding offers (sale without an auction requires the consent of all parties involved). In the first auction, the price for the real estate may not be lower than 70% of the appraised value and in the second auction, the price may not be lower than 50% of the appraised value (lower prices than these require consent of all parties involved).

An out-of-court sale of real estate via a notary is also possible (pursuant to the Financial Collateral Act). Such sale can only be conducted if the mortgage agreement was concluded in the form of a directly enforceable notarial deed and if both the creditor and debtor (pledger) are certain participants in the financial market, *inter alia*, certain public bodies, central banks, credit institutions, etc. (the debtor (pledger) may also be a large, mid-sized or small company). The process is carried out via a collection of mandatory bids by a notary. The opening price must be 70% of the estimated value of real estate. If the collection of mandatory bids is not successful, the creditor may obtain ownership right on the real estate; if the creditor's secured claim exceeds the value of the real estate, he may request the payment of the difference up to the total amount of the claim.

Enforcement on movables. Both in-court and out-of-court sales are possible.

In a court sale, movables are seized by the bailiff, stored and appraised. They can either be sold directly to a buyer or in an auction by the bailiff. The movables shall not be sold for less than the appraised value. If such purchase price cannot be achieved through a direct sale within the set deadline or at first auction, the movables may be sold at auction for a lower purchase price, but in no event for less than one third of the appraised value.

Pledged movables can be sold out of court if the pledger and pledgee entered into a written agreement permitting an out-of-court sale or if the pledge agreement is concluded between business entities (if not explicitly agreed that out of court sale is prohibited). The pledged movables can be sold out of court in a public auction or at a market price. The parties may agree in detail on the procedure for the determination of the market price of movables and the sales process. For non-possessory pledges, agreement on out-of-court sale is presumed (after the pledged movable is handed over to the lender (pledgee)). Note that the lender (pledgee) retains the right to an out-of-court sale of movables even after the initiation of the bankruptcy proceedings.

Enforcement on shares in LLCs. Both in-court and out-of-court sales are possible.

For court sales, generally the same rules as for real estate apply (see above).

An out-of-court sale is possible if the pledger and pledgee entered into a written agreement permitting an out-of-court sale or if the pledge agreement is concluded between business entities (if not agreed explicitly that out of court sale is prohibited). For out-of-court sales, generally the same rules as for movables apply (see above).

Enforcement on shares (stocks) in corporations. Both in-court and out-of-court sales are possible.

Court sales of shares of publicly traded corporations are carried out by an authorised broker. For court sales of shares of corporations that are not publicly traded, generally the same rules as for movables apply (see above).

For out-of-court sales, generally the same rules as for movables apply (see above). An Agreement on out-of-court sales is presumed under the law.

Enforcement on receivables. Both in-court and out-of-court enforcement is possible.

In court enforcement, the debtor's receivable is transferred to the creditor in order to be repaid by the debtor's debtor.

Out of court, the creditor can either collect the receivable (from the debtor's debtor) or sell the receivable and repay himself from the sale proceeds. The sale of receivables is only possible if the pledger and pledgee entered into a written agreement permitting an out-of-court sale (in agreements between business entities, agreement for such is presumed).

7.5 Do restrictions apply to foreign lenders in the event of (a) filing suit against a company in your jurisdiction, or (b) foreclosure on collateral security?

No additional restrictions apply to foreign lenders.

7.6 Do the bankruptcy, reorganisation or similar laws in your jurisdiction provide for any kind of moratorium on enforcement of lender claims? If so, does the moratorium apply to the enforcement of collateral security?

The Slovenian Financial Operations, Insolvency Proceedings and Compulsory Winding-up Act provides for a moratorium on enforcement of lender claims and collateral security. Different rules apply to preventive restructuring proceedings on one hand (PRP) and insolvency proceedings (i.e. bankruptcy and compulsory settlement proceedings) on the other hand.

PRP. During PRP (from the time of the publication of the resolution on the initiation of the proceedings), judicial enforcement of all financial claims is barred and ongoing enforcement proceedings are terminated on request of the debtor. The debtor is deemed not to be at default with payment of the principal amounts of financial claims and the limitation period for financial claims is suspended.

Insolvency Proceedings. All enforcement proceedings initiated against the debtor before the beginning of either a compulsory settlement or bankruptcy proceedings are terminated upon the initiation of such proceedings. No new enforcement procedures can be initiated against the debtor after an insolvency proceeding has been initiated.

7.7 Will the courts in your jurisdiction recognise and enforce an arbitral award given against the company without re-examination of the merits?

Recognition and enforcement of arbitral awards in Slovenia is governed by the Convention on the Recognition and Enforcement of Foreign Arbitral Awards (New York, 1958). In accordance with article III thereof, Slovenia shall recognise arbitral awards as binding and enforce them in accordance with the rules of procedure of the territory where the award is relied upon. Therefore, Slovenian courts will generally not re-examine the merits of the award.

8 Bankruptcy Proceedings

8.1 How does a bankruptcy proceeding in respect of a company affect the ability of a lender to enforce its rights as a secured party over the collateral security?

Secured lenders have a right to separate settlement in bankruptcy proceedings (and other insolvency proceedings), meaning that they have a right to a preferred distribution from the proceeds from the collateral security. Accordingly, unsecured parties are only repaid from the remainder of the proceeds from the collateral security and other assets that are free from collateral.

Note that for the assignee of a receivable to obtain the right to a separate settlement, the assignment agreement must be concluded in the form of a notarial deed. For more, see question 3.4 above.

Also note that, according to the Financial Collateral Act, financial collateral agreements and rights arising from them (including enforcement and set-off rights) remain in full force and effect even after the insolvency proceeding is initiated against the debtor.

8.2 Are there any preference periods, clawback rights or other preferential creditors' rights (e.g., tax debts, employees' claims) with respect to the security?

Creditors have clawback rights if the following conditions are met:

- the debtor in bankruptcy has concluded or carried out the legal transaction or other legal action in the period as of the beginning of the 12 months prior to the introduction of bankruptcy proceedings up to the initiation of bankruptcy proceedings;
- the consequence of such action is either (i) a decrease in the net value of assets of the debtor in bankruptcy, so as to enable other creditors to receive payment for their claims in a smaller portion than if the action had not been done, or (ii) that a person to the benefit of whom the act has been executed, has acquired more favourable payment conditions for a claim against the debtor in bankruptcy (i.e. objective criterion); and
- a person to the benefit of whom the action was executed, at the time when such act was executed, was aware of or should have been aware of the fact that the debtor was insolvent (i.e. subjective criterion).

Note that when another person comes into possession of the debtor's assets without being liable to execute its counter-fulfilment, or for a counter-fulfilment of a small value, such action shall be challengeable irrespective of the fulfilment of the subjective criterion. In these cases, the suspect period extends from 12 to 36 months.

Furthermore a number of claims are considered preferential (e.g. claims arising from salaries, severance pays, taxes and contributions). These preferential claims, however, do not affect creditors' rights to separate settlements arising from the collateral.

8.3 Are there any entities that are excluded from bankruptcy proceedings and, if so, what is the applicable legislation?

Bankruptcy proceedings may generally be conducted against any legal entity. Only a few exceptions apply (e.g. only the Bank of Slovenia can initiate bankruptcy over a bank and a social enterprise may only be the subject of bankruptcy proceedings upon prior approval from the government).

On the other hand, preventive restructuring proceedings (PRP) may only be conducted against a legal entity which (i) is a company with share capital, (ii) is classified as a small, medium-sized or large company in accordance with the Companies Act, and (iii) can be subject to compulsory settlement proceedings.

8.4 Are there any processes other than court proceedings that are available to a creditor to seize the assets of a company in an enforcement?

For rules on out-of-court enforcement proceedings, see question 7.4 above.

9 Jurisdiction and Waiver of Immunity

9.1 Is a party's submission to a foreign jurisdiction legally binding and enforceable under the laws of your jurisdiction?

Generally, choices of court are legally binding and enforceable under Slovenian law.

If the parties agree on jurisdiction of a court in one of the EU Member States. In this case, the Brussels I Regulation shall apply. According to Article 25 of the Brussels I Regulation, such choice of law is valid unless the agreement is null and void as to its substantive validity under the law of that Member State. The agreed-on jurisdiction shall be exclusive unless the parties have agreed otherwise. Specific rules apply regarding the form of the agreement (i.e. agreement in writing is advisable, but not necessarily required).

If the parties agree on jurisdiction of a court in a non-EU country. In this case, Slovenian law shall apply. A choice of court in a non-EU country is permissible provided that (i) at least one of the parties to the agreement on jurisdiction is a foreign citizen or a legal person with their principal place of business abroad, and (ii) no dispute is involved which would be subject to the exclusive jurisdiction of the courts in Slovenia.

9.2 Is a party's waiver of sovereign immunity legally binding and enforceable under the laws of your jurisdiction?

Waivers of sovereign immunity are neither required under Slovenian law nor common in lending agreements governed by Slovenian law. However, in principle, such waivers shall be legally binding and enforceable, unless they conflict with public international law.

10 Licensing

10.1 What are the licensing and other eligibility requirements in your jurisdiction for lenders to a company in your jurisdiction, if any? Are these licensing and eligibility requirements different for a "foreign" lender (i.e. a lender that is not located in your jurisdiction)? In connection with any such requirements, is a distinction made under the laws of your jurisdiction between a lender that is a bank *versus* a lender that is a non-bank? If there are such requirements in your jurisdiction, what are the consequences for a lender that has not satisfied such requirements but has nonetheless made a loan to a company in your jurisdiction? What are the licensing and other eligibility requirements in your jurisdiction for an agent under a syndicated facility for lenders to a company in your jurisdiction?

There are no general licensing and other eligibility requirements for lenders to a company in Slovenia. Since the role of agents under syndicated facilities is not regulated, no specific licensing or other eligibility requirements apply. Requirements and limitations arise primarily from (i) banking regulation, and (ii) consumer lending regulation.

Banking regulation. According to the Banking Act, banks shall only be allowed to provide financial services (e.g. taking of deposits and lending) after obtaining a licence from the Bank of Slovenia. A licence shall be obtained for each of the financial services the bank intends to provide.

Since passporting applies to EU Member States banks, these banks do not need to obtain a separate licence in Slovenia. On the other hand, banks from non-EU countries need to obtain a licence from the Bank of Slovenia and certain additional requirements may apply (i.e. the Bank of Slovenia may require from such foreign bank a deposit of cash or assets or other appropriate financial collateral for obligations arising from business activities of the bank in Slovenia).

Consumer lending regulation. Licensing and eligibility requirements also apply in the field of consumer lending. In accordance with the Consumer Credit Act, several requirements need to be met by a lender to qualify for a licence for granting of consumer loans or financial leasing. These relate to adequate ownership premises, number of employees with certain levels of education and duration of previous work experience, adequate technical and organisational conditions, etc. Stricter requirements apply if real estate is involved as collateral or otherwise connected to the loan. Generally exempted from the requirement to obtain a specific licence are Slovenian and EU Member State licensed credit institutions and those carrying out consumer lending activities via a branch office in Slovenia, as well as public law entities for certain specific retail loans.

Since passporting applies to EU Member States, EU-based consumer lenders, similarly to banks, do not need to obtain a separate licence in Slovenia. Consumer lending by entities from non-EU countries is not permitted under the passporting rules.

Consumer lending without previously obtaining a licence is considered an offence for which a monetary penalty of between EUR 50,000 and EUR 125,000 shall be issued. Such lending shall also be prohibited by the Market Inspectorate.

11 Other Matters

11.1 Are there any other material considerations which should be taken into account by lenders when participating in financings in your jurisdiction?

On 13 February 2018, the Slovenian legislature adopted the amendment to the Claim Enforcement and Security Act, which entered into force on 25 March 2018.

Several provisions of the amendment were aimed at adapting the Claim Enforcement and Security Act to the EU Regulations (including the Brussels I Regulation and Regulation (EU) No 655/2014 establishing a European Account Preservation Order procedure). Due to the direct enforceability of EU regulations, these changes predominantly clarified and amended the procedures to be compliant with the respective regulations.

This amendment also intended to overhaul the rules on the non-possessory pledges register by modernising, simplifying and automating the registration procedure. Data from the non-possessory pledges register will be linked with the tax and business register and automatically updated in real time. A government regulation implementing and specifying these changes shall be adopted by 2020.

Finally, the amendment introduced online auctions and online search engines (operated by the Slovenian Supreme Court) for sale of both real estate and movables. The online auction system is not yet operational, as it has not yet been technically established and regulated by the Ministry of Justice. When established, it will enable users to search for and participate in online auctions and will increase transparency and shorten the enforcement procedures.

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JADEK & PENSA

Jadek & Pensa is a top-tier Slovenian law firm with a strong platform in corporate, M&A, banking, commercial, restructuring, and financial law. We constantly leverage our vast experience in these fields to provide insight and innovative solutions tailored to the individual project.

Jadek & Pensa has been engaged in the most significant transactions in Slovenia since its inception. We have advised foreign and domestic lenders and borrowers in bilateral, club and syndicated lending and restructuring transactions including security documentation, as well as sellers, buyers, financiers, targets and other clients in M&A and commercial matters. As a result, we have developed internal processes and effective document tools for a wide variety of corporate, lending and commercial transactions, which we can effectively deploy for a particular matter and incorporate into a solution in a time effective manner. We also made steps to serve our clients via automated processes responding to market demands with ground-breaking approaches.

South Africa

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1 Overview

1.1 What are the main trends/significant developments in the lending markets in your jurisdiction?

While political uncertainty persists, particularly in the run-up to national elections which are to be held in May 2019, business confidence in South Africa improved over the course of 2018. The South African economy grew by 2.2% quarter-on-quarter in the third quarter of 2018, which brought South Africa back out of a short-lived technical recession. South Africa's foreign direct investment increased by US$2.5 billion in June 2018, compared with an increase of US$878.9 million in the previous quarter.

The dire financial standing of several state-owned entities (SOEs) remains a significant concern for the South African economy. The reform of these SOEs is a key issue for the South African Government. The restructuring and refinancing of these SOEs is likely to be a focus during 2019 as Government tries to restore the integrity and capacity of these institutions.

1.2 What are some significant lending transactions that have taken place in your jurisdiction in recent years?

Significant lending transactions for 2019 include:

- Steinhoff Africa Retail (STAR) raised ZAR18 billion in funding from South African financial institutions in May 2018. Of the ZAR18 billion, ZAR12 billion was raised by way of three- and five-year term facilities and the remaining ZAR6 billion through preference shares issued to South African financial institutions. The funds raised were used (1) to repay shareholder funding provided to STAR by the embattled Steinhoff International Holdings as part of STAR's listing in September 2017 (which in turn facilitated the cancellation of all third-party guarantees related to the financing of the shareholder funding), and (2) for STAR's growth in operations.
- As part of its successful real estate investment trust (REIT) conversion, Liberty Two Degrees Limited acquired ZAR1.2 billion in property assets from Liberty Property Portfolio and internalised the management company of Liberty Two Degrees, and raised debt funding in the funded amount of ZAR1.5 billion.

2 Guarantees

2.1 Can a company guarantee borrowings of one or more other members of its corporate group (see below for questions relating to fraudulent transfer/financial assistance)?

Generally yes, provided the company satisfies the requirements for the granting of financial assistance and (to the extent applicable) the making of a distribution under the relevant provisions of the South African Companies Act, 2008 (the **SA Companies Act**) prior to its obligations under the guarantee coming into force.

See question 4.1 below for the requirements for financial assistance under the SA Companies Act.

2.2 Are there enforceability or other concerns (such as director liability) if only a disproportionately small (or no) benefit to the guaranteeing/securing company can be shown?

There is no requirement under South African law for there to be corporate benefit to the guaranteeing/securing company. Directors have a fiduciary duty both in terms of the SA Companies Act and South African common law to act in good faith and for a proper purpose and in the best interests of a company. A breach of fiduciary duty may attract personal liability for that director.

2.3 Is lack of corporate power an issue?

Under South African law, a company has all the legal powers and capacity of a natural person except to the extent (1) it is incapable of exercising such power or of having such capacity, or (2) its memorandum of incorporation provides otherwise. However, where capacity of a company is limited in terms of its memorandum of incorporation, all third party effects of the limitation are voided. A transaction outside the 'limited' capacity of a company only gives rise to internal remedies. Shareholders, directors or prescribed officers of a company may apply to court to restrain a company from acting contrary to a limitation on its capacity, but any such action is without prejudice to the rights of a third party who obtained such rights in good faith and who did not have actual knowledge of the limitation of capacity. In addition, any action outside the 'limited' capacity of a company is capable of ratification by special resolution of the shareholders. To the extent, however, any limitation applies to a company's ability to grant financial assistance, any provision of financial assistance in contravention of that limitation (or the SA Companies Act) is not capable of ratification.

2.4 Are any governmental or other consents or filings, or other formalities (such as shareholder approval), required?

Under the SA Companies Act, the provision of financial assistance (which includes the granting of a guarantee) requires shareholder approval by way of special resolution (unless such financial assistance is pursuant to an employee share scheme that satisfies the requirements of section 97 of the SA Companies Act) and board approval. The shareholder approval can be generic (i.e. approval for a category of recipients and the recipient falls within that category) or transaction-specific and it must have been adopted within the past two years of the board resolution. Prior to authorising the provision of financial assistance at board level, the board must be satisfied that: (1) the company would satisfy the solvency and liquidity test immediately after providing the financial assistance in question; (2) the terms under which the financial assistance is given are fair and reasonable to the company; and (3) any conditions for financial assistance contained in the company's memorandum of incorporation have been satisfied.

To the extent the financial assistance (i.e. the guarantee) is granted for the benefit of a director or officer of the company or a related or inter-related company and the total value of the financial assistance granted exceeds 1/10th of 1% of the guaranteeing company's net worth at the time the board resolution authorising the financial assistance is taken, the board of the guaranteeing company must give notice of the financial assistance to all shareholders of the company and any trade unions representing employees of the company. This is an administrative step and not a requirement for financial assistance under the SA Companies Act.

As at the date of publication of this guide, there are proposed amendments to the SA Companies Act which include exempting downstream financial assistance (i.e. financial assistance from a holding company to a subsidiary) from the requirements under section 45 of the SA Companies Act. These amendments are expected to be clarified and finalised during the course of 2019.

In addition to financial assistance, a guarantee for the benefit of one or more holders of any shares of the guaranteeing company (i.e. an upstream guarantee) or one or more holders of any shares of another company within the same corporate group constitutes a "distribution" as defined in section 1 of the SA Companies Act and requires board approval under section 46 of the SA Companies Act. This approval must include an acknowledgement that the board has applied the solvency and liquidity test and has reasonably concluded that the company will satisfy the solvency and liquidity test immediately after completing the proposed distribution.

See question 2.5 below for an explanation on the solvency and liquidity test under the SA Companies Act.

2.5 Are net worth, solvency or similar limitations imposed on the amount of a guarantee?

Not strictly, although the board of the guaranteeing company is required to confirm that the company will satisfy the solvency and liquidity test as provided for in the SA Companies Act immediately after providing the financial assistance, and to the extent applicable, immediately after completing the distribution.

The solvency and liquidity test is satisfied if, considering all reasonably and foreseeable financial circumstances of the company at that time the test is applied: (1) the assets of the company (fairly valued) equal or exceed the liabilities of the company (fairly valued); and (2) the company will be able to pay its debts as they become due in the ordinary course of business for the 12-month period following the provision of financial assistance or completion of the distribution, as applicable.

See question 2.6 below regarding limitations that may be imposed by the South African Reserve Bank.

2.6 Are there any exchange control or similar obstacles to enforcement of a guarantee?

Funds flowing in and out of South Africa are subject to exchange control in terms of the Exchange Control Regulations, issued under the Currency and Exchanges Act, 1933 (the **Exchange Control Regulations**). Exchange control is controlled by the Financial Surveillance Department (**FinSurv**) of the South African Reserve Bank. Certain powers set out in the Currency and Exchanges Manual for Authorised Dealers (previously known as the exchange control rulings) have been delegated to authorised dealers, which are banks authorised by FinSurv to deal in foreign exchange.

The enforcement of a guarantee given by a South African resident in favour of a foreign lender is subject to the requisite exchange control approval for that guarantee being in place. The approval must be obtained from FinSurv on application by the South African resident company through its authorised dealer. While there is no regulatory limitation on the amount of a guarantee under the Exchange Control Regulations or rulings, FinSurv has a general discretion to impose any conditions on the approval granted by it. FinSurv has recently tended to include in its approval a limitation that any amount recovered under the guarantee is limited to the net asset value of the guaranteeing company at the time of recovery.

The approval process generally takes between four and six weeks.

3 Collateral Security

3.1 What types of collateral are available to secure lending obligations?

It is possible to take security over most common assets of a South African company.

3.2 Is it possible to give asset security by means of a general security agreement or is an agreement required in relation to each type of asset? Briefly, what is the procedure?

South Africa does not have a universal corporate security interest covering all assets generically. The appropriate form of security is determined by reference to the classification of the assets concerned as immovable (land) or movable and in respect of movable assets, further sub-classification as corporeal (tangible) or incorporeal (intangible).

3.3 Can collateral security be taken over real property (land), plant, machinery and equipment? Briefly, what is the procedure?

Security over immovable property (land) is created by way of registration of a mortgage bond specially mortgaging the land in accordance with the requirements under the Deeds Registries Act, 1937. Registration at the deeds registry where the land is registered perfects the security. There is no prescribed form for mortgage bonds, although there are recommended forms for certain types of mortgage bonds. The content of a mortgage bond is determined by banking and conveyancing practice, the common law and statute law.

Security over plant, machinery and equipment may be caught by any mortgage bond over the land to the extent those assets are sufficiently attached to the mortgaged land and were intended to be annexed permanently to the land. In these circumstances, the plant, machinery or equipment would be classified as immovable property.

Security over plant, machinery or equipment not constituting immovable property under South African property law is usually taken by way of mortgage in the form of either a special notarial bond or a general notarial bond. A special notarial bond is a mortgage by the debtor of specifically identified tangible movable property in favour of a creditor as security for a debt or other obligation. It must comply with the requirements outlined in the Security by Means of Movable Property Act, 1993; including the requirement that the property secured must be clearly identified and described in such a manner which makes it readily recognisable. A special notarial bond must be registered at the deeds registry within three months after the date of its execution. Once registered, the creditor is a secured creditor in the estate of the debtor.

A general notarial bond is a mortgage by the debtor of all its present and future tangible movable property in favour of a creditor as security for a debt or other obligation. A general notarial bond must be registered at the deeds registry within three months after the date of its execution. A general notarial bond does not confer a real right of security in the property concerned unless the creditor obtains possession of the property prior to insolvency of the debtor by way of a perfection order obtained from a court.

Both a special and general notarial bond must be prepared by a notary public and executed by either the owner of the movable assets (the mortgagor) encumbered under the bond or the notary public under a formal power of attorney granted to him by the mortgagor.

It is also possible to grant security over plant, machinery and equipment by way of a pledge, although this form of security requires delivery of the assets concerned, in addition to the agreement to grant the security over the asset, to perfect the security over those assets.

3.4 Can collateral security be taken over receivables? Briefly, what is the procedure? Are debtors required to be notified of the security?

Security over receivables is taken by way of cession. There are no formalities: the security interest is created by the debtor agreeing to grant security by way of cession over the receivables in favour of the creditor.

It is not necessary to notify the underlying debtors of the cession to perfect the security created over the receivables and given the fluctuating nature of receivables, it is fairly uncommon to give notice of the cession to the underlying debtors prior to the occurrence of an event of default. In the absence of notice, however, any payment by an underlying debtor to the security provider following the occurrence of the event of default constitutes a valid discharge by the underlying debtor of its obligations in respect of such receivables and the creditor will have to recover these amounts from the security provider.

3.5 Can collateral security be taken over cash deposited in bank accounts? Briefly, what is the procedure?

Yes, security over cash deposited in a bank account is taken by way of cession.

As discussed above in relation to security over receivables, there are no formalities for a cession: the security interest is created by the debtor agreeing to grant security by way of cession over the cash in the bank accounts in favour of the creditor.

It is more common in the case of a cession over cash in bank accounts to notify the banks of the security interest created at the time of creation of the security interest.

3.6 Can collateral security be taken over shares in companies incorporated in your jurisdiction? Are the shares in certificated form? Can such security validly be granted under a New York or English law governed document? Briefly, what is the procedure?

Yes security can be taken over shares in companies incorporated in South Africa. Shares in a private company are generally in certificated form; while shares in a public company are generally in uncertificated form.

Security over shares in a South African company is taken by way of pledge and cession. Similar to security over receivables and cash in bank accounts, the security interest is created by the debtor agreeing to grant security over the shares in question. There are no other perfection requirements in respect of certificated shares; although it is fairly common to have any share certificates together with undated and blank share transfer forms delivered to the secured creditor at the time of creation of the security interest to facilitate enforcement if needed following the occurrence of default. There is a statutory obligation to "effect" any security interest over shares lodged and immobilised in South Africa's central securities depository (i.e. uncertificated shares) by "flagging" the relevant securities account in accordance with the Financial Markets Act, 2012.

Under South African law, the proper law for a security document granting security over assets situated in South Africa is South African law.

3.7 Can security be taken over inventory? Briefly, what is the procedure?

Yes, security over inventory is possible and usually takes the form of a special or general notarial bond.

See question 3.3 above for the procedure for taking security by way of a special or general notarial bond.

3.8 Can a company grant a security interest in order to secure its obligations (i) as a borrower under a credit facility, and (ii) as a guarantor of the obligations of other borrowers and/or guarantors of obligations under a credit facility (see below for questions relating to the giving of guarantees and financial assistance)?

Yes, provided the requirements for the granting of financial assistance and the making of a distribution under the SA Companies Act are satisfied where applicable.

See question 4.1 below for the requirements for financial assistance under the SA Companies Act.

3.9 What are the notarisation, registration, stamp duty and other fees (whether related to property value or otherwise) in relation to security over different types of assets?

There is no stamp duty or other documentary tax payable under South African law for the granting, or taking, of security. Nominal registration fees are payable for the registration of mortgage bonds, general and special notarial bonds, aircraft mortgages, ship mortgages, hypothecations relating to trade marks, designs and patents. A mortgage bond must be prepared by a conveyancer and a notarial bond by notary public, both of whom are entitled to charge fees on a tariff-fee basis in South Africa calculated by reference to the principal amount of the secured debt for preparing the bonds.

3.10 Do the filing, notification or registration requirements in relation to security over different types of assets involve a significant amount of time or expense?

The costs for the preparation and lodgement of mortgage bonds and notarial bonds can be significant. It is fairly common, however, for conveyancers and notary publics preparing and lodging these documents to offer a fairly significant discount to the tariff rates.

3.11 Are any regulatory or similar consents required with respect to the creation of security?

Exchange control approval is required for the enforcement by a foreign lender of any security granted by a South African resident but it is common practice to obtain this approval prior to the of creation of the security. As discussed in question 2.6 above for exchange control for a guarantee, the approval must be obtained from FinSurv on application by the South African resident company through its authorised dealer. The approval process generally takes between four and six weeks.

There may be particular requirements for regulated entities or assets. For example, a cession over shares in a company that holds a mining licence requires the consent of the Department of Mineral Resources in South Africa.

3.12 If the borrowings to be secured are under a revolving credit facility, are there any special priority or other concerns?

Generally, no.

3.13 Are there particular documentary or execution requirements (notarisation, execution under power of attorney, counterparts, deeds)?

Creditors generally expect to receive board and/or shareholder resolutions approving the transaction for evidentiary purposes and to ensure any financial assistance requirements have been satisfied.

The Uniform Rules of Court (of South Africa) provide for the authentication of any document signed outside of South Africa which is to be received in the courts of South Africa. A document executed outside of South Africa that has not been authenticated in accordance with the Uniform Rules of Court (of South Africa) remains valid and is admissible in evidence in a South African court but there is an evidentiary risk in respect of due execution. This risk can be mitigated in various ways, including but not limited to resolutions passed authorising a person to execute documents, specimen signatures of signatories and copies of passports or identity documents of signatories.

4 Financial Assistance

4.1 Are there prohibitions or restrictions on the ability of a company to guarantee and/or give security to support borrowings incurred to finance or refinance the direct or indirect acquisition of: (a) shares of the company; (b) shares of any company which directly or indirectly owns shares in the company; or (c) shares in a sister subsidiary?

Both a private and public company are restricted from providing financial assistance (including by way of guarantee or security) in connection with the acquisition of:

(a) its own shares;

(b) the shares of its holding company; and

(c) the shares in a sister company,

unless the financial assistance has been approved in accordance with the relevant provisions of the SA Companies Act.

The board of a company may not authorise the provision of any financial assistance unless that financial assistance is pursuant to an employee share scheme under section 97 of the SA Companies Act or has been approved by way of a special resolution of the shareholders of that company that provides for generic approval for a category of recipients and the recipient falls within that category or for transaction specific approval. The shareholder resolution must have been adopted within the past two years of the board resolution. Further, the board must be satisfied that: (1) the company would satisfy the solvency and liquidity test immediately after providing the financial assistance in question; (2) the terms under which the financial assistance is given are fair and reasonable to the company; and (3) any conditions for financial assistance contained in the company's memorandum of incorporation have been satisfied.

The SA Companies Act also restricts the provision of financial assistance to a director or officer of the company or a related or inter-related company of the company granting the financial assistance. The requirements discussed above apply equally in these circumstances.

See question 2.5 for an explanation on the solvency and liquidity test under the SA Companies Act.

5 Syndicated Lending/Agency/Trustee/ Transfers

5.1 Will your jurisdiction recognise the role of an agent or trustee and allow the agent or trustee (rather than each lender acting separately) to enforce the loan documentation and collateral security and to apply the proceeds from the collateral to the claims of all the lenders?

South African law does recognise the concept of a trust. However, the security trustee structure recognised under English and New York law is not recognised under South African law. South African law requires that the security provider owe a valid principal obligation (not an accessory obligation) to the creditor. The security trustee structure does not meet this requirement.

5.2 If an agent or trustee is not recognised in your jurisdiction, is an alternative mechanism available to achieve the effect referred to above which would allow one party to enforce claims on behalf of all the lenders so that individual lenders do not need to enforce their security separately?

Where a security agent is used for the purpose of holding South African security, a parallel debt arrangement is normally used in order to ensure that the security can be validly given to the security agent. The security interest, however, vests in the estate of the security agent and as a result, lenders take insolvency risk on the security agent.

Another alternative structure commonly used in South African law-governed transactions entails the establishment of a separate special purpose vehicle (known as the security SPV) to act as a beneficiary of the security granted by the security provider. The security SPV will provide a guarantee to the creditors for all of the secured obligations of the security provider, and the security provider will provide an indemnity to the security SPV. The shares in the security SPV are held by an owner trust.

5.3 Assume a loan is made to a company organised under the laws of your jurisdiction and guaranteed by a guarantor organised under the laws of your jurisdiction. If such loan is transferred by Lender A to Lender B, are there any special requirements necessary to make the loan and guarantee enforceable by Lender B?

Exchange control approval is required for a loan (whether in Rand or foreign currency denominated) made to a South African resident by a foreign lender as well the granting of security or a guarantee by the South African resident in favour of the foreign lender.

Any change in the foreign lender does not require fresh approval but must be notified to the exchange control authorities through the relevant authorised dealer.

6 Withholding, Stamp and Other Taxes; Notarial and Other Costs

6.1 Are there any requirements to deduct or withhold tax from (a) interest payable on loans made to domestic or foreign lenders, or (b) the proceeds of a claim under a guarantee or the proceeds of enforcing security?

Yes, interest payable to or for the benefit of a foreign lender is subject to withholding tax at the rate of 15% to the extent that the amount is regarded as having been received or accrued from a source within South Africa under the South African Income Tax Act, 1962 (the **SA Income Tax Act**), unless the levying of withholding tax is exempted under the applicable provisions of the SA Income Tax Act or the amount of withholding tax is reduced as a result of a double taxation treaty.

Under the SA Income Tax Act, the exemptions relevant to withholding tax on interest fall into three broad groups:

- the payor (i.e. the person paying the interest);
- the instrument (i.e. the instrument giving rise to the interest, for example the debt or the investment); and
- the recipient of the interest.

A foreign person is exempt from the withholding tax on interest if the debt claim for which interest is paid is effectively connected with a permanent establishment of that foreign person if that foreign person is registered as a taxpayer in South Africa.

It is not clear from the current wording of the withholding tax provisions of the SA Income Tax Act whether the proceeds of a claim under a guarantee representing any amount of interest under the loan would be subject to withholding tax. The current market view is that this is not the case.

6.2 What tax incentives or other incentives are provided preferentially to foreign lenders? What taxes apply to foreign lenders with respect to their loans, mortgages or other security documents, either for the purposes of effectiveness or registration?

There are no preferential tax incentives for foreign lenders lending into South Africa.

6.3 Will any income of a foreign lender become taxable in your jurisdiction solely because of a loan to, or guarantee and/or grant of, security from a company in your jurisdiction?

A foreign lender is not liable to pay tax in South Africa by reason only of its entering into a loan or exercising its rights (including taking steps to enforce its rights) under a loan, guarantee or security agreement.

Unless an exemption under the SA Income Tax Act applies, a foreign lender may be subject to tax on income that has, or is deemed to have, its source in South Africa. Income is or will be deemed to have its source in South Africa if, for example, it relates to rental on property situated in South Africa. South African-sourced interest which is received or accrued by or to a foreign lender is exempt unless the debt from which the interest arises is effectively connected to a permanent establishment of that foreign lender in South Africa.

See question 6.1 above for the application of withholding tax on payments of interest under a loan to a foreign lender.

6.4 Will there be any other significant costs which would be incurred by foreign lenders in the grant of such loan/guarantee/security, such as notarial fees, etc.?

There is no stamp duty or other documentary tax payable under South African law on the execution of enforcement of a loan or guarantee.

See question 3.9 for fees associated with taking security in certain circumstances.

6.5 Are there any adverse consequences for a company that is a borrower (such as under thin capitalisation principles) if some or all of the lenders are organised under the laws of a jurisdiction other than your own? Please disregard withholding tax concerns for purposes of this question.

If one of the lenders is connected to the South African borrower and a tax benefit has arisen, the South African borrower cannot claim, in terms of section 31 of the SA Income Tax Act, a deduction of interest on any portion of the financing that is not at arm's length (i.e. any excessive portion of the financing). There are essentially two requirements that must be met before section 31 can be applied: (1) the terms and conditions of the transaction must differ from what they would have been had the parties been independent persons acting at arm's length (i.e. unconnected persons); and (2) the transaction must result (currently or in the future) in a tax benefit being derived by a person that is a party to the transaction. 'Tax benefit' is defined in the SA Income Tax Act as any avoidance, postponement or reduction of any liability for tax under the SA Income Tax Act.

Further, the amount of interest that may be deducted by the South African borrower is limited under section 23M of the SA Income Tax Act if: (1) the lender is in a controlling relationship with the borrower or it has obtained the funding from a person that is in a controlling relationship with the borrower; and (2) the amount of interest is not subject to tax in South Africa in the hands of the foreign lender. If the interest paid to the foreign lender is subject to withholding tax, the provisions of section 23M do not apply. A 'controlling relationship' is one where a person holds (directly or indirectly) 50% of the equity shares in a company or at least 50% of the voting rights in a company.

The location of any unconnected lender has no other adverse consequences for a South African borrower (disregarding withholding tax concerns).

7 Judicial Enforcement

7.1 Will the courts in your jurisdiction recognise a governing law in a contract that is the law of another jurisdiction (a "foreign governing law")? Will courts in your jurisdiction enforce a contract that has a foreign governing law?

South African law gives effect to the choice of law exercised by contracting parties, subject to certain exceptions. Where foreign governing law applies, the applicable legal position is often the subject of expert evidence in litigation or arbitration proceedings. There are certain aspects which cannot be governed by the law chosen by the parties, however. For example, the proper law for a security document granting security over assets situated in South Africa is South African law.

7.2 Will the courts in your jurisdiction recognise and enforce a judgment given against a company in New York courts or English courts (a "foreign judgment") without re-examination of the merits of the case?

A foreign judgment is not automatically enforceable in South Africa but does constitute a cause of action and would be recognised and enforced by the South African courts (on application brought under the Enforcement of Foreign Civils Judgments Act, 32 of 1988) without re-examination of the merits of the case, provided:

- the court which pronounced the judgment had jurisdiction to entertain the case according to the principles recognised by South African law with reference to the jurisdiction of foreign courts;
- the judgment is final and conclusive in its effect and has not become superannuated;
- the recognition and enforcement of the judgment would not be contrary to public policy in South Africa;
- the judgment was not obtained by fraudulent means;
- the judgment does not involve the enforcement of a penal or revenue law of the foreign state; and
- the enforcement of the judgment is not precluded by the provisions of the Protection of Businesses Act, 1978. This Act requires that the consent of the Minister of Trade and Industry be obtained before certain foreign judgments can be enforced. The South African courts have interpreted the ambit of the Act restrictively and the current market view is that the ambit of the Act would appear not to include loans from, or guarantees to, foreign lenders.

7.3 Assuming a company is in payment default under a loan agreement or a guarantee agreement and has no legal defence to payment, approximately how long would it take for a foreign lender to (a) assuming the answer to question 7.1 is yes, file a suit against the company in a court in your jurisdiction, obtain a judgment, and enforce the judgment against the assets of the company, and (b) assuming the answer to question 7.2 is yes, enforce a foreign judgment in a court in your jurisdiction against the assets of the company?

(a) A South African court will exercise jurisdiction in a contractual dispute notwithstanding the chosen law of the agreement being foreign, if the normal grounds for jurisdiction exist. A foreign lender, like any local lender, can initiate legal proceedings in one of two ways: by way of action for matters involving a factual dispute, or (less likely in the circumstances) by way of application for matters where no factual dispute exists but involves application of the relevant law in question.

An action is initiated by way of service of summons. After formal service of that summons by the Sheriff of the Court, the defendant must file a notice of intention to defend if he wishes to oppose the action (within 10 court days after service). Two scenarios arise:

- If no notice of intention to defend is filed, the foreign lender can apply to the registrar of the court for default judgment without further notice to the defendant. This procedure, if successful, takes approximately four weeks from initiation of proceedings.
- If the defendant delivers a notice of intention to defend, and the claim is liquid (which is likely to be the case in the context of this query) the foreign lender can apply for summary judgment. The courts are reluctant to grant summary judgment unless the foreign lender has satisfied the court that the defendant has no *bona fide* defence and has entered a notice of intention to defend solely for the purposes of delaying the action. The summary judgment procedure, if successful, takes approximately six to eight weeks from initiation of proceedings. If the defendant is able to demonstrate under oath that it has a *bona fide* defence, alternatively, the defendant puts up security for the sum claimed in the summons, the matter will proceed to trial and it is likely that the court will grant an adverse costs order against the foreign lender. A full trial procedure usually takes between one to two years from initiation of the proceedings given an unfortunate backlog in the South African courts as regards the allocation of trial dates.

(b) A foreign lender seeking to enforce a foreign judgment in South Africa must first apply to a local court for an order recognising the judgment. If the foreign judgment satisfies the requirements for its recognition as discussed in question 7.2 above and the local court grants an order recognising it, the foreign lender can enforce the judgment in the ordinary course as if it were a judgment of a South African court – i.e. the foreign lender can obtain a writ of execution and attach the defendant's assets for sale in execution in satisfaction of the judgment.

7.4 With respect to enforcing collateral security, are there any significant restrictions which may impact the timing and value of enforcement, such as (a) a requirement for a public auction, or (b) regulatory consents?

In the case of foreclosing on a mortgage bond or a general notarial bond where the secured creditor is not in possession of the assets, the secured creditor would need to first obtain a court order before enforcement. This will have an impact on the cost and timing of recovery.

Regulatory consents may be required if the company is a regulated entity or the assets are regulated.

7.5 Do restrictions apply to foreign lenders in the event of (a) filing suit against a company in your jurisdiction, or (b) foreclosure on collateral security?

No, foreign lenders are essentially treated the same as domestic lenders. A defendant will, however, be entitled to request (on application to the registrar, or court, depending on the circumstances) that the foreign lender provide security for the defendant's legal costs.

7.6 Do the bankruptcy, reorganisation or similar laws in your jurisdiction provide for any kind of moratorium on enforcement of lender claims? If so, does the moratorium apply to the enforcement of collateral security?

On liquidation, a *concursus creditorum* occurs and the estate of the insolvent is essentially frozen. The aim in liquidation is to realise the unsecured assets of the company for the benefit of creditors as a whole (save for secured creditors). All legal proceedings against the company are suspended until the appointment of a liquidator and any civil attachment of assets of the company after insolvency proceedings have been commenced is void. A secured creditor is not entitled to enforce its rights under its security agreement but must rather deliver any secured property held by it to the liquidator of the insolvent estate for realisation. There are limited circumstances in which a secured creditor may realise certain secured assets itself without the consent of the liquidator of the insolvent estate. These limited circumstances relate to where the secured property comprises marketable securities (i.e. property ordinarily sold through a stockbroker); financial instruments or bills of exchange. Any cash proceeds realised through any disposal of the secured assets would then have to be turned over to the liquidator unless an agreement is reached with the liquidator for the lender to retain the proceeds subject to paying the fees of the liquidator and Master of the High Court.

A company in "financial distress" may be placed into business rescue with the aim of rehabilitating the company by providing for the temporary supervision and management of the company's affairs and business by a business rescue practitioner. During business rescue, no creditor may institute any legal proceedings or take any enforcement action (including enforcement of any collateral security) against the company. In certain circumstances proceedings may be brought against the company with the written consent of the business rescue practitioner or with the leave of the court.

The terms and effect of any reorganisation of a company (including whether any moratorium applies) by way of compromise with its creditors will depend on terms agreed between the company and all its creditors.

7.7 Will the courts in your jurisdiction recognise and enforce an arbitral award given against the company without re-examination of the merits?

In terms of the recently promulgated International Arbitration Act, 2017 (the **International Arbitration Act**) (which came into effect on 20 December 2017), the Model Law on International Commercial Arbitration, as adopted by the United National Commission on International Trade Law, has been wholly adopted into South African law for the purposes of international arbitral awards. In effect, as regards to enforcement of arbitral awards:

- a foreign arbitral award is binding between the parties to that foreign arbitral award, and may be relied upon by those parties by way of defence, set-off or otherwise in any legal proceedings;
- a foreign arbitral award must be made an order of court on application to court;
- a foreign arbitral award may be enforced in the same manner as any judgment or order of court, and the party seeking such order must produce: an original award and arbitration agreement (as authenticated in a manner acceptable to a South African court (i.e. by a notary public, or certified as true originals)); and, if issued in a foreign language, an authenticated sworn translation or the award and arbitration agreement;
- a court may only refuse to recognise or enforce a foreign arbitral award if:
  - the court finds that a referral to arbitration of the subject matter of the dispute is impermissible in South African law, or is contrary to public policy;
  - the parties against whom the award is invoked proves to the satisfaction of the court that:
    - a party to the arbitration agreement had no capacity to contract under the law applicable to that party;
    - the arbitration agreement is invalid under the law to which the parties have subjected it, and, where no law is subjected, the law of the country in which the arbitral award was made;
    - the required notice was not given as regards to the appointment of an arbitrator, and/or the constitution of an arbitration, and that party was not able to present its case;
    - the arbitral award is beyond the arbitrator's jurisdiction – i.e. it deals with a dispute not contemplated by/falling within the terms of reference/scope of the arbitrator's appointment;
    - the constitution of the arbitration proceedings was not in accordance with or provided for in the arbitration agreement or the law of the country in which it is constituted; and
    - the award is not yet binding on the parties, has been set aside or suspended by a competent authority in the country in which, or under the law of which, the arbitral award was made;
- an arbitral award can be recognised and enforced in part, provided that the aspects which a party seeks to enforce can be separated from the rest of the award; and
- where an application for the setting aside or suspension of an award had been made to a competent authority, the court where recognition or enforcement is sought may, where appropriate, adjourn its decision *and*, on application by the party seeking recognition and enforcement, order the other party against whom the arbitral award is being invoked to provide suitable security.

Importantly, as regards to the applicability of the International Arbitration Act, the provisions will apply to all international commercial arbitration agreements regardless of whether they were entered into before or after the commencement of the new International Arbitration Act. It will not, however, apply where:

- proceedings for the enforcement of an arbitral award under the old Act; or
- proceedings for the enforcement, setting aside or remittal of an arbitral award under the Arbitration Act (42 of 1965),

were already in progress prior to 20 December 2017 – i.e. the old position will still apply to such proceedings.

8 Bankruptcy Proceedings

8.1 How does a bankruptcy proceeding in respect of a company affect the ability of a lender to enforce its rights as a secured party over the collateral security?

A secured creditor is not entitled to enforce its rights under its security agreement during insolvency proceedings but must rather deliver any secured property held by it to the liquidator of the insolvent estate for realisation. There are limited circumstances in which a secured creditor may realise certain secured assets itself without the consent of the liquidator. These limited circumstances relate to where the secured property comprises marketable securities (i.e. property ordinarily sold through a stockbroker); financial instruments or bills of exchange. Any cash proceeds realised through any disposal of the secured assets would then have to be turned over to the liquidator unless an agreement is reached with the liquidator for the lender to retain the proceeds subject to paying the fees of the liquidator and Master of the High Court.

8.2 Are there any preference periods, clawback rights or other preferential creditors' rights (e.g., tax debts, employees' claims) with respect to the security?

Certain pre-liquidation contracts can be set aside by a liquidator exercising anti-avoidance (or clawback) powers afforded to it under the SA Insolvency Act. Clawback could be available in relation to: dispositions (commonly known as impeachable dispositions) made not for value; dispositions having the effect of preferring creditors and not made in the ordinary course of business; dispositions made with intent to prefer creditors; collusive dealings; and dispositions in fraud of creditors.

The definition of a "*disposition*" in terms of the SA Insolvency Act is very wide, and is designed to cover every loss of rights to property, which includes the granting of security.

A disposition will only qualify as an impeachable disposition if it was made at a time when the debtor's liabilities exceed its assets or, in the case of a disposition at no value, the debtor's estate was rendered insolvent by the disposition. For this purpose, "insolvent" means that the insolvent's liabilities must exceed the value of his assets (fairly valued) at the date of the disposition.

Where a special notarial bond or mortgage bond is passed over assets to secure a debt and such bond is not registered within two months of the debt being incurred, and the debtor is liquidated within six months of the registration of the notarial bond or mortgage bond, no preference is recognised under the notarial bond or mortgage bond and the lender effectively loses its security.

Creditors in the insolvent estate are paid according to the following order of rank:

- costs of liquidation – this includes the costs of court application; the liquidator and masters fees; and sheriff's costs;
- secured creditors – payment is made to secured creditors from the proceeds of a sale of the secured assets (after the proportionate liquidation costs have been deducted from the proceeds of the realised secured asset). Where a secured creditor's claim is not secured in full, the unpaid balance is treated as a concurrent claim. Secured claims include mortgage bonds over immovable property which are satisfied in the order in which they are registered or recorded; pledges over movable property; special notarial bonds registered over movable property are satisfied in the order in which they are registered; and cessions over intangible movable property;
- preferent creditors – these are creditors who do not hold security for their claims but rank above the claims of concurrent creditors. They are paid from the proceeds of the unencumbered assets (the free residue) in a pre-determined order as follows:
  - the salary and wages of employees (and certain other amounts payable to, or on behalf of, employees);
  - certain statutory obligations (such as amounts owing to the workmen's compensation fund; any customs or sales tax due under the Customs Excise Act, 1964; any value-added tax or penalty due under the Value-Added Tax Act, 1991; and any amounts owing to the unemployment insurance fund);
  - income tax; and
  - preferential claims arising from bonds giving preferences (i.e. general notarial bonds or special notarial bonds registered before 7 May 1993);
- concurrent creditors – these are creditors who are paid from the proceeds of the free residue that remains after preferent creditors have been paid in full in proportion to the amounts owed to them;
- subordinated creditors – if they have subordinated their claims to the claims of concurrent creditors; and
- shareholders (holders of preference shares generally take priority to holders of ordinary shares).

8.3 Are there any entities that are excluded from bankruptcy proceedings and, if so, what is the applicable legislation?

Special legislation and special insolvency regimes may apply to certain businesses (e.g. banks/credit institutions and investment firms).

8.4 Are there any processes other than court proceedings that are available to a creditor to seize the assets of a company in an enforcement?

The lender and security provider may agree that the lender has a right (called *parate executie*) to sell the secured assets without an order of court by public auction to the highest bidder or in such manner as may be otherwise agreed between the parties.

The debtor may seek the protection of the court if, on any just ground, he can show that, in carrying out the agreement and effecting a sale, the creditor acted in a manner which prejudiced the debtor in his rights, is valid in respect of a security interest created over movable property.

An agreement in a mortgage bond entitling the mortgagee to resort to *parate executie* by taking possession of the property and selling it privately is, however, invalid.

9 Jurisdiction and Waiver of Immunity

9.1 Is a party's submission to a foreign jurisdiction legally binding and enforceable under the laws of your jurisdiction?

Generally yes, submission to a foreign jurisdiction is legally binding and enforceable under South African law. However, as per the Foreign States Immunities Act, 87 of 1981, the inherent jurisdiction of the South African courts cannot be ousted and, as such, a South African court may exercise its discretion not to take cognisance of the submission to foreign jurisdiction clause in commercial transactions with a foreign state, or, where the obligations of a foreign state (in terms of a contract, whether a commercial transaction or not) falls to be performed wholly or partly in South Africa. Commercial transactions falling within the ambit of the Foreign States Immunities Act relate to: (i) any contract for the supply of services or goods; (ii) a loan or other transaction for the provision of finance, and any guarantee or indemnity in respect of any such loan or other transaction, or, of any other financial obligation; and (iii) other transactions/activities, or a commercial, industrial, financial, professional or other similar character contract into which a foreign state enters, or in which it engages other than in the exercise of sovereign authority. It does not, however, include a contract of employment between foreign state and an individual.

9.2 Is a party's waiver of sovereign immunity legally binding and enforceable under the laws of your jurisdiction?

Yes, sovereign immunity may be waived as per the Foreign States Immunities Act, 87 of 1981. More particularly, a waiver of immunity may be effected after the dispute which gave rise to the proceedings has arisen, or by prior written agreement.

A provision in an agreement that it is to be governed by the law of South Africa shall not be regarded as a waiver, but, a foreign state shall be deemed to have waived its immunity: (i) if it has instituted the proceedings; or (ii) if it has intervened or taken any step in the proceedings (save for where this "step" is taken for the purpose of claiming immunity, or asserting an interest in property in circumstances such that the foreign state would have been entitled to immunity if the proceedings had been brought against it). A waiver in respect of any proceedings shall also apply to any appeal and to any counter-claim arising out of the same legal relationship or facts as the claim.

10 Licensing

10.1 What are the licensing and other eligibility requirements in your jurisdiction for lenders to a company in your jurisdiction, if any? Are these licensing and eligibility requirements different for a "foreign" lender (i.e. a lender that is not located in your jurisdiction)? In connection with any such requirements, is a distinction made under the laws of your jurisdiction between a lender that is a bank *versus* a lender that is a non-bank? If there are such requirements in your jurisdiction, what are the consequences for a lender that has not satisfied such requirements but has nonetheless made a loan to a company in your jurisdiction? What are the licensing and other eligibility requirements in your jurisdiction for an agent under a syndicated facility for lenders to a company in your jurisdiction?

Lending activity as such is not a regulated activity in South Africa unless credit is provided to consumers (i.e. retail lending activity). However, under the Banks Act, 1990 (the **SA Banks Act**) no person may conduct "the business of a bank" unless such person is a public company and registered as a bank under the SA Banks Act. The business of a bank is widely defined and includes accepting deposits from the general public as a regular feature of the business in question. The SA Banks Act does not define nor offer guidance as to what constitutes the "general public" but it is generally understood to refer, with reference to the SA Banks Act, to any section of the public, irrespective of any pre-selective or pre-determinative criteria applicable to a particular group of persons. It would not include any private or domestic arrangements.

The South African Reserve Bank is responsible for bank regulation and supervision in South Africa. It is not, however, necessary under the laws of South Africa that a foreign lender is licensed, qualified or otherwise entitled to carry on business in South Africa to enable it to exercise its rights (including taking steps to enforce its rights) under any lending arrangements entered into with a South African borrower, or to enter into or perform its obligations under the lending arrangements.

11 Other Matters

11.1 Are there any other material considerations which should be taken into account by lenders when participating in financings in your jurisdiction?

Under the Financial Advisory and Intermediary Services Act, 2002 (**FAIS**), no person may provide intermediary services or advice to clients in respect of financial products (including insurance products; bank deposits and securities) unless that person has been issued a licence under FAIS. Authorised financial service providers holding the requisite licence under FAIS are bound by principles and rules set out in the applicable codes of conduct created by the Financial Sector Conduct Authority (previously known as the Financial Services Board), the regulatory body responsible for administering FAIS.

Foreign investors should also consider a recent piece of legislation, the Protection of Investment Act, 2015, which came into force and effect on 13 July 2018. This Act replaces South Africa's bilateral investment treaties (BITs). The stated aim of the Act is to provide for the protection of investors and their investments in South Africa in accordance with and subject to the Constitution of South Africa in a manner which balances the public interest and the rights and obligations of investors. The Act has, however, been criticised for (amongst other things): (i) creating uncertainty as to whether expropriation without compensation is a risk for foreign investment assets, particularly as the expropriation clause in the Act intentionally mirrors section 25 (Property) of the Constitution of South Africa, which section is currently under review to determine whether it should be amended to explicitly provide for expropriation without compensation; and (ii) providing for a dispute resolution process that requires ministerial consent and facilitation and exhaustion of domestic remedies before a request for international arbitration can be made or considered. Given the recent enactment of the Act and the consequent lack of judicial precedent, there is little guidance as to how the relevant provisions of the Act will be construed or applied.

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Spain

Manuel Follía

Cuatrecasas

Iñigo Várez

1 Overview

1.1 What are the main trends/significant developments in the lending markets in your jurisdiction?

From a wide macroeconomic perspective, Spain continues to benefit from a healthy growth rate (2.6% in 2018) above the average in the euro area. Whilst the Spanish economy still faces some major challenges, such as the control of public debt and the stabilisation of the labour market, the structural changes implemented in the growth model – such as the reduction of the deficit – have been essential to support an optimistic perspective on the Spanish economy.

According to the Bank Lending Survey issued by the Bank of Spain on January 2019, Spanish banks anticipate a slight tightening in all lending sectors. Although bank financing will continue to be the main source of financing, businesses and individuals are turning their eyes more frequently to non-traditional sources of funding.

The demand for consumer credit and other lending has remained stable in 2018 after several quarters of strong growth. This was the outcome of several factors exerting opposing effects. On one side, the overall low level of interest rates, greater spending on consumer durables and increased consumer confidence were decisive in the growth of loan demand. On the other side, the rise in internal financing via savings, alongside the use of external financing different from banks, had an effect in the opposite direction.

It is worth flagging that Spain remains one of the largest European markets for non-performing assets and is a preferred jurisdiction for international investors. There has been a significant increase in the sale of NPLs in 2018 due to several factors, including the additional capital requirements for NPLs, which means that banks are prioritising these sales to reduce the impact on their balance sheets and improve their ratios. This fact linked with the boosting of real estate market and the overall increase in the quantity and quality of this sort of transactions in our market has created a very positive environment for the acquisition of REO portfolios.

1.2 What are some significant lending transactions that have taken place in your jurisdiction in recent years?

2018 has seen a continued rise in lending transactions as investors began to regain interest in the Spanish lending market, which has allowed us to expand both nationally, and internationally, through our core lending business and the continued development of our distressed debt practice. Some of our year's highlights would be the following:

Corporate refinancing and debt restructuring processes: For some years now, we have been actively participating in debt refinancing and restructuring processes, involving large national and international companies, which have required forming multidisciplinary teams with a high international element. Some examples include our advice in the debt restructuring of El Corte Inglés (€3.6 billion), FCC (€3.3 billion), AENA (€1.25 billion), Hispania (€745 million), Elecnor (€500 million) Toys "R" Us ($375 million) and Grupo Villar Mir ($365 million).

Project and real estate finance: Our team was very active last year and was involved in several projects in Spain and abroad, particularly Latin America.

In Spain, we highlight our advice to Forestalia on financing nine wind farms (Project Goya, 300 MW), and photovoltaic projects (Project Phoenix, 800 MW) (€600 million), as well as on refinancing the debt of thermosolar plants Helios I and Helios II (Abengoa) (€300 million), on financing the acquisition of three hospital centres managed by Quirón Salud (€200 million), on funding Planiger to refinance the existing debt and finance the purchase of care homes (€166 million), and on financing to build and operate a 49.9 MW in Cáceres.

And, in Latin America, we advised Pemex in several projects, including in: the Litoral Project in the Gulf of Mexico (€1.5 billion), in an offshore gas compression platform in the Ku-Maloop-Zaap field ($420 million), and in different luxury hotel complexes in Mexico; the Cerro Dominador project, a solar concentration plant based in the Atacama desert in Chile (US $238 million); the Mar 1 highway project in Colombia (€115 million); and the Inxu Geradora project, a hydro electrical power plant (US $108 million), and six transmission lines in Brazil.

Distressed debt: We are one of the most specialised law firms advising on distressed debt transactions, acquisition of corporate debt, loan portfolios and restructuring debt processes. We have been chosen by major international and prestigious funds and have advised either the distressed/special situations funds (as a purchaser), or the financial institution (as a seller) in many significant deals. Among others, some recent transactions include advising on the sale of non-performing loans portfolios such as Project Tramuntana, Far, Egeo, Nilo, Jets and Gregal, clearly showing the Spanish banks' interest in cleaning up their balance sheets and international investors' interest in Spanish assets.

2 Guarantees

2.1 Can a company guarantee borrowings of one or more other members of its corporate group (see below for questions relating to fraudulent transfer/financial assistance)?

Although some financial assistance restrictions need to be taken into consideration (see question 4.1 below), there are no significant legal restrictions on corporate guarantees. Having said that, there are certain formalities that need to be conducted when granting guarantees for the benefit of other members of their group, such as the shareholder approval attesting that they are aware of the transaction and that they are confident that the transaction envisioned is sound from a general corporate perspective and will benefit the group as a whole. Unlike other EU jurisdictions, there is no specific obligation for Spanish companies to justify that they are acting for corporate benefit reasons when granting a guarantee or security, although it is advisable to do so based on the characteristics of a specific transaction, or to ensure the effectiveness of the security or guarantee if the grantor becomes insolvent. These formalities have the main aim of avoiding any presumption of gratuity in an insolvency scenario that could challenge the validity of such guarantees and activate any potential claw back claim from third-party debtors.

2.2 Are there enforceability or other concerns (such as director liability) if only a disproportionately small (or no) benefit to the guaranteeing/securing company can be shown?

All directors should act when conducting business with the diligence of an "orderly entrepreneur". Moreover, any individual forming part of a management body should generally comply with the various duties foreseen in the applicable law, the articles of association and other internal rules with due care, abiding by the shareholders decisions and following standard market criteria that enhances the performance and growth of the business. Furthermore, all directors should avoid any situation when a potential conflict of interest may arise in the performance of their duties and shall refrain from adopting decisions when they can reasonably foresee that such decisions may have a negative impact on the business.

This last duty is inextricably linked with any potential liability towards them when adopting the decision to secure borrowings from a different member of the group. In an eventual insolvency scenario, there is a potential risk that the insolvency administrators might presume that the granting of collateral by the company could have resulted in the insolvency and allege that it is detrimental to the insolvency estate. In these situations, it is paramount to follow the guidelines established in question 2.1 above as well as to include certain limitation language in the collateral documentation and in the corporate resolutions, to mitigate any potential liability.

2.3 Is lack of corporate power an issue?

Yes, in Spain the agreements need to be executed by duly empowered representatives of the company with sufficient corporate power to act on its behalf.

2.4 Are any governmental or other consents or filings, or other formalities (such as shareholder approval), required?

Usually, no governmental consents or filings are required to grant guarantees or security interests in Spain (see question 3.11 below) unless the company falls under the scope of any public regulation or is directly or indirectly governed by any public authority, where the adoption of such actions can be limited or subject to further formalities and consents.

Regarding internal corporate approvals, in general terms, any actions or activities which fall within the scope of the corporate purpose of the company are subject to fewer formalities. However, in case of private limited liability companies (*sociedades de responsabilidad limitada*), shareholders' approval may need to be obtained before carrying out certain transactions. In public limited liability companies (*sociedades anónimas*), despite not being mandatory, the shareholders' approval is also usually obtained (see question 2.1 above for more information on corporate benefit).

If the amount of the guarantee represents an excess of 25% of the value of the assets which appear in the latest balance sheet of the company – having the consideration of an "essential asset" as per the Spanish Companies Act – it is also required to obtain the shareholders' approval. The aim of this regulation is to reserve for the general meeting the approval of certain transactions which, due to their financial significance, can have similar effects to those of a structural modification, even though, from a technical perspective, they do not constitute such kind of transaction.

2.5 Are net worth, solvency or similar limitations imposed on the amount of a guarantee?

No, although certain limitation language is included in case of a disproportionate benefit between the borrowing company and the guaranteeing/securing company (see question 2.2 above for more information).

2.6 Are there any exchange control or similar obstacles to enforcement of a guarantee?

There are no exchange control regulations on the enforcement of a guarantee. However, Spanish Insolvency Law imposes an important restriction on lenders facing imminent or real insolvency of its debtors, as any termination clauses solely based on insolvency of the debtor which may have been included by the parties in an agreement are deemed as non-applicable or non-enforceable.

3 Collateral Security

3.1 What types of collateral are available to secure lending obligations?

The most commonly used types of collateral in the framework of a financing transaction are generally classified into two main groups: (1) *in rem* security interests, the most frequent being: (i) mortgage over real estate (*hipoteca inmobiliaria*); (ii) ordinary pledge over movable assets with transfer of possession (*prenda ordinaria*) (e.g., pledge over shares, over credit rights or over bank accounts); (iii) chattel mortgage (*hipoteca mobiliaria*) over business premises, aircraft, machinery or equipment; and (iv) non-possessory pledge over assets (*prenda sin desplazamiento de la posesión*); and (2) personal guarantees, mainly being first demand guarantees (*garantías a primer requerimiento*).

The main difference between *in rem* security interests and personal guarantees is that, in the former, a specific asset secures fulfilment of the obligation, while in the latter, an individual or corporate entity guarantees fulfilment of the obligation. As briefly highlighted below, there are also material differences in proceedings for their treatment and enforcement during insolvency ("*concurso*") under the Spanish Insolvency Act ("*Ley Concursal*").

3.2 Is it possible to give asset security by means of a general security agreement or is an agreement required in relation to each type of asset? Briefly, what is the procedure?

Spanish law does not provide for a so-called "universal security" over the global debtor's assets. Therefore, traditionally, a security agreement is usually required in relation to each type of asset. Nor does it generally admit the creation of a "floating" lien or encumbrance (i.e., a variable guarantee over assets) except for certain mortgages over real estate (*hipoteca flotante*) and some analogous figures that enable the creation of security over several assets such as the pledge over inventory or the pledge over furniture, fixtures and equipment (FF&E), generally used in real estate transactions. As a basic premise, it is paramount to flag that only financial entities (and not investment funds) can be beneficiaries of the so-called floating mortgage (*hipoteca flotante*) that allows security over different obligations under a single umbrella agreement.

The creation of guarantees and security interests requires the notarisation of the agreements by means of which they are granted. Such notarisation allows the agreements to qualify as executive title (*título ejecutivo*) in an enforcement scenario, pursuant to article 517 of the Spanish Law on Civil Procedure. Notarial deeds (being either *pólizas notariales* or *escrituras públicas*) provide certainty of the date and content of the applicable document *vis-à-vis* third parties. Furthermore, some of these types of security interests are subject to compulsory entry on public registries, such as the Land Registry (*Registro de la Propiedad*) (e.g., real estate mortgage) or the Chattel Registry (*Registro de Bienes Muebles*) (e.g., mortgage on inventory or non-possessory pledge over assets), while such registration is not required for other collateral (e.g., ordinary pledge with transfer of possession).

3.3 Can collateral security be taken over real property (land), plant, machinery and equipment? Briefly, what is the procedure?

Real property is taken as security by means of a real estate mortgage (*hipoteca inmobiliaria*). Under Spanish law, real estate mortgages cover: (i) the plot of land and the buildings built on it; (ii) the proceeds from any insurance policies covering such property; and (iii) the improvement works carried out on the property and natural accretions. Should the parties agree to it, such mortgage may also include movable items located permanently in the mortgaged property.

Security over machinery and equipment may be created by means of a chattel mortgage (*hipoteca de maquinaria industrial*) or a non-possessory pledge (*prenda sin desplazamiento de maquinaria industrial*). The choice will depend on whether the specific asset meets certain legal requirements.

Further formalities for the abovementioned security (other than notarisation of the security agreement as set forth under question 3.2 above) involve the registration of such security with the corresponding Spanish registries: the Property Registry (*Registro de la Propiedad*) with regards to the mortgages, and the Chattel Registry (*Registro de Bienes Muebles*) with regards to the non-possessory pledge.

3.4 Can collateral security be taken over receivables? Briefly, what is the procedure? Are debtors required to be notified of the security?

Security over receivables can be taken in two different manners: (i) by creating a possessory pledge *(prenda ordinaria)*; or (ii) by creating a non-possessory pledge (*prenda sin desplazamiento de la posesión*) which needs to be registered in the Chattel Registry.

With regards to the possessory pledge over receivables, in order for the pledge to be perfected, it is required that the debtor be notified of the granting of the pledge.

On the contrary, the non-possessory pledge (*prenda sin desplazamiento de la posesión*) does not require notification to the relevant debtor, since the publicity *vis-à-vis* third parties is obtained through the filing of such pledge with the relevant Chattel Registry.

Further to the above, those claims which are secured by a pledge over future receivables shall be considered as "privileged" in an insolvency proceeding, so long as the following requirements are met: (i) the security interest granted is documented by means of a public deed (*escritura pública*) when it comes to ordinary pledges; or (ii) the security interest is formalised by means of a deed (*póliza notarial*) and is registered in the relevant Chattel Registry in case of a non-possessory pledge.

3.5 Can collateral security be taken over cash deposited in bank accounts? Briefly, what is the procedure?

The pledge over bank accounts is simply a pledge over the receivables arising in favour of the holder of a bank account *vis-à-vis* the bank, which should typically correspond or be equal to the account balance.

The formal requirements which apply are identical to those of any other possessory pledge over receivables. The creation of the pledge does not imply, unless otherwise agreed by the parties, the freezing of the account, although some reservations as to how the balance may be disposed by the debtor are typically included in the security agreement.

On a different note, in the event of pledges over bank accounts securing cash settlements of financial instruments (such as netting-based financial agreements), it may be possible to subject the pledge to a specific regime regulated under Royal Decree 5/2005.

3.6 Can collateral security be taken over shares in companies incorporated in your jurisdiction? Are the shares in certificated form? Can such security validly be granted under a New York or English law-governed document? Briefly, what is the procedure?

Yes, it is certainly possible, and it is one of the most common and frequent types of security in Spanish financing transactions.

If the shares to be pledged belong to a private limited company (*sociedad limitada*), and taking into account that quota units (*participaciones*) are not represented by issued certificates (contrary to shares (*acciones*) of public limited companies (*sociedad anónima*)), possession is transferred by means of the execution of a notarial deed of pledge and the registration of the pledge in the Registry Book of Shareholders (*Libro Registro de Socios*) of the relevant pledged company. It is customary that the granting of the pledge is also recorded in the title of ownership to further attest the granting of such collateral.

When the shares belong to a public limited company (*sociedad anónima*), transfer of possession is achieved as follows: (i) if the share certificates (*títulos múltiples* or *resguardos provisionales*) have been issued, by endorsing the relevant title certificate and registering the pledge in the Registry Book of Shares (*Libro Registro de Acciones*); or (ii) if no share certificates have been issued, by means of registration of the pledge in the Registry Book of Shares.

In both cases, it is also advisable (and standard market practice) for the pledgee to request and obtain a certificate issued by the company's secretary representing that the pledge has been registered in the Registry Book of Shareholders or the Registry Book of Shares (as applicable), which will also comply with the requirement of notifying the pledge to the company whose shares are being pledged. Also, such kind of certificate normally includes several representations of the company, such as the absence of previous liens or encumbrances over such shares.

When the pledged company's shares are represented by means of book entries (*anotaciones en cuenta*), the pledge must be registered in the relevant account, becoming enforceable against third parties once registered in the book entry register. In the case of shares traded on a Spanish secondary market, the book entry register will be held by a central clearing house. On request, the entity responsible for the book entry register will issue a certificate stating that the pledge has been entered.

3.7 Can security be taken over inventory? Briefly, what is the procedure?

Yes, Spanish law foresees a specific mechanism for creating security over inventory, which is the non-possessory pledge over inventory (*prenda sin desplazamiento de inventario*). As provided in questions 3.2 and 3.3 above, this type of collateral requires notarisation as well as registration in the relevant Chattel Registry. The notarial deed will need to include a very comprehensive description of the inventory for the pledge to be duly recorded in the relevant registry.

However, it is also possible to create a security over inventory by granting a chattel mortgage over a business (*hipoteca de establecimiento mercantil*), which will include not only the inventory, but the whole business.

3.8 Can a company grant a security interest in order to secure its obligations (i) as a borrower under a credit facility, and (ii) as a guarantor of the obligations of other borrowers and/or guarantors of obligations under a credit facility (see below for questions relating to the giving of guarantees and financial assistance)?

Subject to the financial assistance and the corporate benefit previously explained under question 2.1, as a general rule, the principle of integrity (*principio de especialidad*) (by virtue of which a security interest can secure only one main obligation and its ancillary obligations, such as interest, costs, etc.) must be complied with, which in practice means that when there are two different main obligations which need to be secured, two different security interests (over different assets or portions of the same asset) must be created. However, a certain degree of flexibility is envisioned under Spanish law for those transactions where, despite the existence of several obligations, all of them abide by a clear and single purpose and an inextricable link can be evidenced between them. In these situations, the parties involved in the transaction can resort to certain figures to circumvent the principle of integrity such as the equalisation of rank among the security or the creation of second and subsequent ranks in the security.

3.9 What are the notarisation, registration, stamp duty and other fees (whether related to property value or otherwise) in relation to security over different types of assets?

For possessory pledges to be enforceable *vis-à-vis* third parties, a notarised agreement (*póliza notarial*) or, as the case may be, a deed (*escritura pública*) must be entered into. This is due to the fact that it is presumed that these public documents verify the date and the terms and conditions of the pledge.

Some other types of security are subject to compulsory notarisation and registration on public registries, which has certain implications in terms of cost, mainly due to: (i) registration fees, which vary in accordance with the amount of the secured liability (approximately 0.02% of the secured liability); and (ii) stamp duty of 0.5% to 1.5% of the secured liability (principal, interest and any related costs), depending on the region where the collateral is located. Stamp duty is not levied on ordinary pledges.

Notarial fees are calculated on the basis of fixed criteria, which provides a means to calculate the amount of their fees and which vary in accordance with the amount of the secured liability (approximately 0.03% of the secured liability), although in transactions with an aggregate value over six million euros (€6,000,000), such fees may be reduced if negotiated with the notary.

3.10 Do the filing, notification or registration requirements in relation to security over different types of assets involve a significant amount of time or expense?

For security documents that need to be filed within a public registry, the expected elapsed time from the date the documents are notarised to the actual registration by the public registry is usually from two to six weeks. Nevertheless, on occasion, public registries consider that necessary amendments need to be made to the relevant security document in order to comply with registration criteria, which may delay registration and increase the previously mentioned term.

3.11 Are any regulatory or similar consents required with respect to the creation of security?

Regulatory or other consents with respect to the creation of security over real property or machinery would apply only in very limited cases, depending on the exact location of the asset, its nature and the parties involved (e.g. mortgage over administrative concessions, which would require the approval by the relevant administrative body).

3.12 If the borrowings to be secured are under a revolving credit facility, are there any special priority or other concerns?

In rem security interests securing a financing have, as a general rule and according to the Spanish Insolvency Act, the status of credits with special privilege. This privilege will be granted to claims arising under the credit facility as a whole, independent of the fact that it is of a revolving nature.

3.13 Are there particular documentary or execution requirements (notarisation, execution under power of attorney, counterparts, deeds)?

As explained in question 3.2 above, in Spain security interests are almost always notarised. To appear before a Spanish notary public, all parties must be duly empowered (they can act under powers of attorney, which in case of foreign entities must bear an apostille in accordance with The Hague Convention or a legalisation from the relevant consulate or other competent body). The original power of attorney will need to be provided to the Spanish notary public so that due capacity of the authorised representative is duly attested.

Signature in counterparts is not used in Spanish law governed agreements. It is worth mentioning that all parties that are signatories to a Spanish notarial deed must have a Spanish Tax Identification Number (*Número de Identificación Fiscal* or "NIF"), even for non-resident parties and their non-resident attorneys (either individuals or entities), which must request such number before the Spanish Tax Authorities (*Agencia Tributaria*).

Additionally, the Spanish Anti-Money Laundering Law (*Ley 10/2010, de 28 de abril, de prevención del blanqueo de capitales y de la financiación del terrorismo*), requires certain disclosure obligations when executing transactions before a Spanish notary public (with certain exceptions, such as those for listed companies or certain financial institutions). In particular, individuals executing a public deed before a notary public on behalf of a company need to disclose the identity of the ultimate beneficial owner (*titular real*) of the company, which is:

- the ultimate shareholder or shareholders (individuals) of the company, in the event that a certain person holds (individually), directly or indirectly, a stake exceeding 25% in the share capital of this company; or
- the individual which directly or indirectly controls the management of such company (being understood as control the capacity to name more than half of the members of such management body).

In the event that no individuals hold such a direct or indirect stake or control, the directors/members of the management body of the company are to be regarded as the ultimate beneficial owners and need to be identified too by providing a copy of their passports.

4 Financial Assistance

4.1 Are there prohibitions or restrictions on the ability of a company to guarantee and/or give security to support borrowings incurred to finance or refinance the direct or indirect acquisition of: (a) shares of the company; (b) shares of any company which directly or indirectly owns shares in the company; or (c) shares in a sister subsidiary?

Generally, Spanish law prohibits funds being provided (whether by way of loans, guarantees or any other kind of financial support made available before or after the acquisition) by a target company to a third party so that the third party is able to acquire the target company's shares or quotas, or by any other company in the group to which the target company belongs.

Financial assistance is currently prohibited in Spain for:

(a) *sociedades anónimas* (*S.A.*) (public limited companies): for their own shares or the shares of any direct or indirect parent company; and

(b) *sociedades de responsabilidad limitada* (*S.L.*) (private limited companies): for their own units and the units of any member of their corporate group.

This prohibition to give financial assistance includes assistance whether by provision of funds or by way of granting of loans, credits, guarantees, security or otherwise. The legal sanction is the nullity of the agreement and, if fraud can be evidenced, nullity of the agreements for the actual acquisition of the shares.

5 Syndicated Lending/Agency/Trustee/Transfers

5.1 Will your jurisdiction recognise the role of an agent or trustee and allow the agent or trustee (rather than each lender acting separately) to enforce the loan documentation and collateral security and to apply the proceeds from the collateral to the claims of all the lenders?

Spanish law does not recognise trusts as a legal concept. Therefore, security trustees, although used in transactions where foreign lenders are involved, are seldom used for a Spanish security package. Instead, lenders tend to appoint an agent for the Spanish security, which holds the security in its own name and on behalf of the other lenders.

It is possible for a security agent to enforce claims on behalf of the lenders and the other secured parties, as long as each party grants a notarised power of attorney in favour of the security agent. Such power of attorney must expressly authorise the security agent to carry out the enforcement proceedings on behalf of the lenders.

This system nevertheless has two issues; from a practical perspective: (i) Spanish banks are reluctant to grant powers of attorney to other banks, and prefer to appear themselves throughout the enforcement proceedings; and (ii) from a legal perspective, authors and case law are inconsistent regarding the role of an agent acting on behalf of a syndicate of lenders upon enforcement.

5.2 If an agent or trustee is not recognised in your jurisdiction, is an alternative mechanism available to achieve the effect referred to above which would allow one party to enforce claims on behalf of all the lenders so that individual lenders do not need to enforce their security separately?

As stated in question 5.1 above, the appointment of an agent for Spanish security is usual market practice for cross-border financings. The capacity of the agent to act on behalf of the rest of the parties will be evidenced by means of the due empowerment complying with all the relevant formalities.

5.3 Assume a loan is made to a company organised under the laws of your jurisdiction and guaranteed by a guarantor organised under the laws of your jurisdiction. If such loan is transferred by Lender A to Lender B, are there any special requirements necessary to make the loan and guarantee enforceable by Lender B?

In Spain, debt is traded through assignment (*cesión*), and due to the accessory nature of security interests under Spanish law, any assignment of a participation in a secured financing agreement would automatically entail the proportional assignment of the security interests granted to secure such assigned debt by virtue of article 1,528 of the Spanish Civil Code.

However, for certain types of collateral (mainly those acceding to registers such as mortgages and non-possessory pledges), in order to be effective against third parties the assignment of the relevant collateral must be notarised and registered with the relevant public registry.

6 Withholding, Stamp and Other Taxes; Notarial and Other Costs

6.1 Are there any requirements to deduct or withhold tax from (a) interest payable on loans made to domestic or foreign lenders, or (b) the proceeds of a claim under a guarantee or the proceeds of enforcing security?

In general, interest that Spanish borrowers pay for loans made to domestic lenders (other than financial institutions) is subject to 19% withholding tax in 2018. Likewise, interest income payable on loans made to non-EU tax residents is subject to 19% withholding tax, unless a lower rate applies under a tax treaty (treaty rates range between 5% and 15%). Interest payments to EU residents and EU permanent establishments (except those residing in tax-haven jurisdictions) are not subject to withholding tax (irrespective of whether payments are made to a financial institution or a company).

Second, proceeds of a claim under a guarantee or the proceeds of enforcing security are generally subject to withholding tax as if these payments were made by the borrower.

Since 2012, under the Spanish Corporate Income Tax Act, there have been some limitations to the deductibility of financial expenses:

(a) Financial expenses derived from intergroup indebtedness are not tax-deductible if the funds are used to make capital contributions to other group entities, or to acquire from other group entities shares in other entities, unless the taxpayer proves there are valid economic reasons for doing so.

Overall, financial expenses deriving from indebtedness used for any other reason are fully deductible, unless anti-abuse clauses apply.

However, since 1 January, 2015, interest paid for leveraged buy-out share acquisitions is not tax-deductible unless the following requirements are met:

- Indebtedness must be lower than 70% of the purchase price.
- Indebtedness will be reduced proportionally in the eight years following the transaction by up to 30% of the mentioned price.

(b) Net financial expenses (financial expenses minus financial income) exceeding 30% of the operating profit for the financial year are not tax-deductible, with a minimum of €1 million deductible amount guaranteed. Net financial expenses that, by applying the 30% limit, are not tax-deductible, may be deductible in the following financial years without a time limitation. If the 30% limit is not reached, the difference may increase the applicable limit for the following five financial years.

(c) Interests paid on shareholder loans or participative loans granted by another company, which is part of the same group of companies under Section 42 of the Spanish Commercial Code, are not tax-deductible.

Additionally to the limitations set above, financial expenses, arising from transactions carried out between related parties, are not tax-deductible when the interests paid are not taxed because of the application of different legal qualification under local regulations (i.e. when those interests paid are considered as dividends under the lender's local regulations.

6.2 What tax incentives or other incentives are provided preferentially to foreign lenders? What taxes apply to foreign lenders with respect to their loans, mortgages or other security documents, either for the purposes of effectiveness or registration?

As a member of the European Union, Spain benefits from free movement of capital within the EU, including exchange rate fluctuations and transaction costs. Therefore, Spain's EU membership represents a significant part of its foreign policy.

Additionally, Spain currently has more than 90 income tax treaties in force and a solid treaty network with Latin American countries that reduce or eliminate Spanish taxes payable to residents of treaty countries. In this sense, on July 7th, 2017, Spain signed the OECD multilateral instrument, which modifies a large number of existing bilateral tax treaties by including anti-tax avoidance measures developed in the BEPS project.

These provisions could affect the tax treatment of interests paid by Spanish borrowers to foreign lenders but a case-by-case analysis should be carried out. These provisions could also affect to the withholding taxes applicable to dividends.

The main tax incentive is the Spanish international holding companies ("**ETVEs**") regime, a well-established legal framework that has helped Spain become one of the most favourable jurisdictions in the EU to channel and manage international investments. ETVEs can benefit from an exemption on inbound and outbound dividends and capital gains provided several requirements are met. Since ETVEs are Spanish regular entities, they are treated like regular limited liability companies, thus benefitting from tax treaties signed by Spain and from EU Directives.

Under Spanish law, no relevant additional taxes apply to foreign investments besides those applicable to Spanish investors.

6.3 Will any income of a foreign lender become taxable in your jurisdiction solely because of a loan to, or guarantee and/or grant of, security from a company in your jurisdiction?

No, under current Spanish Corporate Income Tax regulations, interest or fees paid to the lenders will not be subject to any withholding or deduction, provided that the lenders are lending entities or financial credit establishments entered on the special registries of the Bank of Spain and have their registered office in Spain, or entities resident in the European Union that have submitted certification of their tax residence.

6.4 Will there be any other significant costs which would be incurred by foreign lenders in the grant of such loan/guarantee/security, such as notarial fees, etc.?

To be able to enforce any rights regarding third parties and benefit from summary proceedings (see question 7.3 below), a loan, a guarantee or a security document must be notarised and eventually registered (depending on the asset).

For more detailed information on notarial and registry fees and stamp duty tax, please see question 3.9 above.

6.5 Are there any adverse consequences for a company that is a borrower (such as under thin capitalisation principles) if some or all of the lenders are organised under the laws of a jurisdiction other than your own? Please disregard withholding tax concerns for purposes of this question.

Most tax consequences do not differ as a result of the tax residency or applicable law of the borrower. Exceptionally, adverse tax consequences (documentation obligations and other anti-abuse measures) might arise when the borrower/lender is a tax resident in a tax-haven jurisdiction.

7 Judicial Enforcement

7.1 Will the courts in your jurisdiction recognise a governing law in a contract that is the law of another jurisdiction (a "foreign governing law")? Will courts in your jurisdiction enforce a contract that has a foreign governing law?

Yes, courts in Spain recognise a foreign governing law in contracts in line with Regulation (EC) No. 593/2008 of the European Parliament and of the Council of 17 June, 2008 on the law applicable to contractual obligations ("*Regulation Rome I*").

Regulation Rome I has *erga omnes* effects. Hence, whatever it is, the foreign law chosen to govern a contract is enforceable, irrespective of whether or not it is an EU Member State.

Spanish Courts will certainly enforce a contract governed by foreign law; however, the choice of the parties will not avoid the application of *ius cogens* provisions of Spanish law that cannot be derogated by private agreement (public policy) between the parties such as those relating to consumers' interests, labour law and insurance or distribution contracts. Also, the content and validity of foreign law must be proved in the proceedings; if the foreign law is not proved, the court will resort to Spanish law.

7.2 Will the courts in your jurisdiction recognise and enforce a judgment given against a company in New York courts or English courts (a "foreign judgment") without re-examination of the merits of the case?

A distinction must be made between judgments rendered in English courts or courts of EU Member States and judgments rendered in New York ("**NY**") courts.

Regarding a judgment rendered in English courts, Council Regulation (EC) No. 1215/2012 of December 12th, 2012 on jurisdiction and the recognition and enforcement of judgments in civil and commercial matters ("*Regulation Brussels I recast*"), establishes that a judgment rendered in an EU Member State is to be recognised without special proceedings in any other EU Member State, unless the recognition is contested. Under no circumstances can the merits of a foreign judgment be reviewed. A declaration that a foreign judgment is enforceable is to be issued following purely formal checks of the documents supplied.

However, a judgment will not be recognised if: (i) the recognition is manifestly contrary to public policy in the EU Member State in which recognition is sought; (ii) the defendant was not served with the document that instituted the proceedings in sufficient time and in such a way as to enable the defendant to arrange for his defence; (iii) it is irreconcilable with a judgment given in a dispute between the same parties in the EU Member State in which recognition is sought; (iv) it is irreconcilable with an earlier judgment given in another EU or non-EU country involving the same cause of action and the same parties; or (v) the judgment was adjudicated by a court lacking jurisdiction in case of exclusive jurisdiction.

Regulation Brussels I recast does not apply to a judgment rendered in NY courts. In the absence of a multilateral or bilateral treaty between Spain and the United States addressing the matter, under the recent Act 29/2015, on International Cooperation, final judgment rendered by US courts will have the same force as is given in the US provided that it complies with the requirements for its recognition set forth in article 46 of the Act on International Cooperation (inter alia, the judgment does not infringe Spanish public policy, the defendant has been properly served with the originating process, the matter is not subject to Spanish exclusive jurisdiction for certain matters, or is not in contradiction with a previous Spanish judgment). Once the exequatur is granted, the judgment can be enforced according to the rules set forth in the Spanish Civil Procedure Act.

7.3 Assuming a company is in payment default under a loan agreement or a guarantee agreement and has no legal defence to payment, approximately how long would it take for a foreign lender to (a) assuming the answer to question 7.1 is yes, file a suit against the company in a court in your jurisdiction, obtain a judgment, and enforce the judgment against the assets of the company, and (b) assuming the answer to question 7.2 is yes, enforce a foreign judgment in a court in your jurisdiction against the assets of the company?

This depends primarily on whether the enforcement action is grounded on an executive title, such as public instruments (i.e. a public deed), or on an ordinary title, such as private contracts.

(a) Executive titles can be enforced directly, through summary proceedings, which consist of a swift procedure that should take between nine and 18 months. Otherwise, the so-called ordinary proceedings, which inevitably lead to a decision which should be enforced through an enforcement proceeding, may take on average between 12 and 18 months plus the nine to 18 months of the enforcement proceeding.

(b) Enforcement of an English court decision will follow the same proceeding as explained in point a), given that the judgment will be recognised without special proceedings. Enforcement of a US judgment would require prior exequatur proceedings (it takes on average between six and nine months). Once the judgment has been recognised, enforcement will follow the same proceeding as explained in point (a) above.

7.4 With respect to enforcing collateral security, are there any significant restrictions which may impact the timing and value of enforcement, such as (a) a requirement for a public auction, or (b) regulatory consents?

Enforcement of collateral security is typically carried out through a public auction (by means of an online auction), in the context of judicial or notarial proceedings. For notarial enforcements, see question 8.4 below. Additionally, the enforcement of pledges over credit rights may also be achieved through set-off or assignment of claims.

The rights derived from the relevant security can be judicially enforced either through declaratory civil proceedings or summary proceedings. The latter action is faster and more effective, while the former is costly and time-consuming. However, to start summary proceedings certain requirements must be met, particularly the determination of the due and payable amount in accordance with the Civil Procedure Act.

Once the court has published a date for auction, the debtor will only be able to object under limited circumstances, such as the prior extinction of the pledge, full payment of the secured obligation, the existence of a material mistake or the existence of abusive clauses.

Concerning the enforcement of pledges over shares, the Financial Collateral Directive was transposed in Spain by means of Royal Decree Law 5/2005, which sets forth a speedy proceeding that applies to obligations of a "financial" nature and which permits direct appropriation of the collateral by the creditor where the financial agreement expressly states so.

7.5 Do restrictions apply to foreign lenders in the event of (a) filing suit against a company in your jurisdiction, or (b) foreclosure on collateral security?

Generally, there is no distinction between domestic and foreign entities when it comes to foreclosing Spanish security.

7.6 Do the bankruptcy, reorganisation or similar laws in your jurisdiction provide for any kind of moratorium on enforcement of lender claims? If so, does the moratorium apply to the enforcement of collateral security?

Bankruptcy declaration triggers an automatic stay of one year (unless the debtor gets the approval of a composition agreement or files for liquidation earlier). This automatic stay concerns secured creditors with collateral over assets that are necessary to continue the ordinary course (except security interests subject to the special regime on financial collateral). Exceptionally, the above standstill period will not apply if the insolvency judge determines that the assets which constitute the object of security are not devoted to the business activity of the insolvent company, do not constitute a productive unit of such company or, eventually, such asset is not necessary for the continuation of the business operations.

During the stay, the bankruptcy officer may decide to treat the secured claim as an administrative expense (pre-deductible claims from the estate) in order to avert enforcement of the security interest.

This automatic stay can also apply if the debtor serves a "5 *bis*" notice, which enables the debtor to negotiate an out-of-court solution to financial distress in a four-month period. The stay of enforcement actions, which does not apply to public claims, lasts for a three- or four-month period (there are different criteria) and concerns assets that are necessary to continue the ordinary course. Yet any enforcement action conducted by holders of financial claims may be stayed if the debtor obtains a standstill supported by 51% of the financial claims. Security interests subject to the special regime on financial collateral escape this automatic stay in any event.

Lastly, if the secured creditor fails to enforce the security interest prior to liquidation (or reinitiate the formerly stayed enforcement proceeding as a result of bankruptcy declaration), it may lose control over the collateral if the liquidation plan sets forth the sale of the business unit as a going concern. In exchange for losing control to enforce the security interest on a stand-alone basis, secured creditors obtain a portion of the price equivalent to the weight of the collateral in the estate. If that percentage of the price is less than the value recognised in the proceeding for the security interest, secured lenders that did initiate the enforcement proceeding prior to bankruptcy declaration, but did not reinitiate it after the one-year automatic stay, such lenders have a veto right as to the approval of the liquidation plan, unless 75% in value of the secured claims from the same class (financial, labour, public, commercial) were to consent to it.

Lastly, the Civil Procedure Act provides the moratorium on enforcement on the grounds of criminal procedure may halt the enforcement and performance of such agreements until the criminal court issues a final resolution in such proceedings.

On another front, the Civil Procedure Act provides a moratorium on enforcement on the grounds of criminal procedure which may halt the enforcement and performance of such agreements until the criminal court issues a final resolution in such proceedings.

7.7 Will the courts in your jurisdiction recognise and enforce an arbitral award given against the company without re-examination of the merits?

Yes, Spain has been a party to the 1958 New York Convention on Recognition and Enforcement of Foreign Arbitral Awards ("New York Convention") since 1977, and it is therefore subject to recognition and enforcement of foreign arbitral awards in the terms established therein.

Given that Spain has not presented any reservations to the New York Convention, its proceedings are applied to the enforcement of all arbitral awards, including those rendered in countries that did not sign the convention. The Spanish Arbitration Act specifically establishes that the exequatur of foreign awards will be governed by: (i) the New York Convention, without prejudice to the provisions of other, more favourable international treaties on the granting of foreign awards; and (ii) the proceedings established in the civil procedural system for judgments handed down by foreign courts.

Spanish courts will not re-examine the merits of the case. However, an arbitral award might not be recognised if certain requirements are not met (e.g. the arbitration agreement is not valid, irregularity in the composition of the arbitration authority or in the arbitral procedure, etc.). Furthermore, an award will not be recognised if the subject matter cannot be settled by arbitration in Spain or the recognition is contrary to the public policy of Spain.

8 Bankruptcy Proceedings

8.1 How does a bankruptcy proceeding in respect of a company affect the ability of a lender to enforce its rights as a secured party over the collateral security?

Bankruptcy declaration triggers an automatic stay of one year (unless the debtor gets the approval of a composition agreement or files for liquidation earlier). This automatic stay concerns secured creditors with collateral over assets that are necessary to continue the ordinary course (except security interests subject to the special regime on financial collateral or relating to collateral located outside of Spain).

During the stay, the bankruptcy officer may decide to treat the secured claim as an administrative expense (pre-deductible claims from the estate) in order to avert enforcement of the security interest.

This automatic stay can also apply if the debtor serves a "5 *bis*" notice, which enables the debtor to negotiate an out-of-court solution to financial distress in a four-month period. The stay of enforcement actions lasts for a three- or four-month period (there are different criteria) and concerns assets that are necessary to continue the ordinary course. Yet any enforcement action conducted by holders of financial claims may be stayed if the debtor obtains a standstill supported by 51% of the financial claims. Security interests, subject to the special regime on financial collateral, escape this automatic stay in any event. Besides, public claims cannot be affected in any way by a "5 *bis*" notice.

Lastly, if the secured creditor fails to enforce prior to liquidation, it may lose control over the collateral concerning business units sales, in which case it would get a portion of the price equivalent to the weight of the collateral in the estate. Even secured creditors having enforced prior to liquidation may lose control over the collateral within the framework of business units sales, provided they receive a percentage of the price equivalent to the security interest value as recognised in the bankruptcy proceeding (otherwise, individual consent would be needed unless 75% of the secured claims from the same class sign off). The claim comprising the difference between the resulting price and the value of the secured claim (the deficiency claim) will be classified as unsecured.

8.2 Are there any preference periods, clawback rights or other preferential creditors' rights (e.g., tax debts, employees' claims) with respect to the security?

Pursuant to compulsory priority rules, claims are divided into privileged, ordinary, and subordinated. Privileged claims, which are in turn divided into special privileged (secured) claims and general privileged claims (such as certain torts, tax, social security and employees' claims), are given preferential treatment over ordinary claims, which in turn have preference over subordinated claims. A controlling principle is the equal treatment of creditors from the same class.

Administrative expenses (*créditos contra la masa*) have a cash flow privilege over claims (*créditos concursales*). In contrast to administrative expenses, claims can only be settled pursuant to a plan of reorganisation or with the proceeds arising out of liquidation (either piecemeal or, preferably, as a going concern business). Having said that, secured creditors may auction or repossess the collateral to apply the proceeds thereof to settle their claims (over which administrative expenses have no priority).

Acts or transactions beyond the ordinary course of business entered into within two years prior to bankruptcy declaration may be subject to clawback, so long as: (i) the debtor does not receive reasonably equivalent value in exchange; or (ii) certain creditors are preferred to others when the company is currently insolvent (i.e. unable to regularly pay its debts as they come due). The hardening period in both cases is two years.

The law sets forth certain rebuttable and non-rebuttable presumptions of transactions that are detrimental to the estate. There are also certain safe harbours (namely acts and transactions done within the ordinary course of business, and certain ring-fenced out-of-court solutions).

Actual intent or fraud is not required to bring a clawback action successfully. Yet, in case of actual fraud the reach-back period is four years (and the action can be brought both within and aside from an insolvency proceeding). Moreover, fraud is a requirement to claw back security interests subject to the special regimen on financial collateral.

Concerning acts or transactions subject to foreign law, the defendant may thwart the clawback action by proving that such act or transaction is ring-fenced under applicable law.

8.3 Are there any entities that are excluded from bankruptcy proceedings and, if so, what is the applicable legislation?

Governmental entities of any type (whether territorially based – such as national, regional, municipal authorities – or of a functional nature) are excluded from bankruptcy proceedings. However, companies directly or indirectly controlled by governmental entities are subject to general bankruptcy law.

Additionally, certain types of companies (such as insurance companies) are subject to specific insolvency regulations, although the composition, appointment and operation of the insolvency administration will still be regulated by general bankruptcy law.

8.4 Are there any processes other than court proceedings that are available to a creditor to seize the assets of a company in an enforcement?

Yes, out-of-court enforcement proceedings, available for certain types of security, are typically carried out by a Notary Public and take the form of a public auction. The terms and conditions of such auction are not entirely regulated in the law and hence they usually follow the provisions agreed by the parties in the relevant security documents. Absent a specific agreement, the Notary Public also tends to follow equivalent provisions applicable to judicial enforcements.

In the case of security over bank accounts or listed securities, particularly when the secured obligation consists of cash settlement agreements or derivative contracts, secured lenders may appropriate directly and immediately the secured assets (or offset), without conducting a public auction. Equally, certain regional laws (such as Catalonian law) expressly permit either private sales or, in the case of highly liquid security, appropriation by set-off.

9 Jurisdiction and Waiver of Immunity

9.1 Is a party's submission to a foreign jurisdiction legally binding and enforceable under the laws of your jurisdiction?

The submission by the parties of an agreement to a foreign jurisdiction is valid, binding and enforceable in Spain:

(i) in the case of submission to the courts of an EU Member State: in accordance with the provisions on *prorogation of jurisdiction* contained in Regulation Brussels I recast (*supra* question 7.2), except in cases where the rules on exclusive jurisdiction of the Regulation are to be applied (in general, concerned with proceedings referred to: (a) *in rem* rights or tenancies in immovable property; (b) the validity of the constitution, nullity or dissolution of companies or other legal persons, or the validity of the decisions of their organs; (c) the validity of entries in public registers; (d) the registration of patents, trademarks, designs or other similar rights subject to deposit or registration; and (e) the enforcement of judgments);

(ii) in the case of submission to non-EU foreign courts abided by conventions: in accordance with the applicable international bilateral conventions (*ad ex*. Hague Convention of June 30th, 2005 on Choice of Court Agreements); or

(iii) in the case of submission to foreign courts not covered by conventions: in accordance with the Spanish Organic Law of the Judiciary, such submission would be valid, unless the exclusive jurisdiction of the Spanish courts is violated (in general, the same cases described *supra* in (i) (a) to (e), with regard to Regulation Brussels I recast).

9.2 Is a party's waiver of sovereign immunity legally binding and enforceable under the laws of your jurisdiction?

Under Spanish law, the waiver of sovereign immunity (either of jurisdiction or of execution) by a foreign state is legally valid and enforceable. The waiver may be explicit (by means of an international agreement, a written contract or a declaration, or a written communication made within the proceedings to the relevant tribunal) or tacit (as a result of certain acts on the side of the foreign state), in accordance with Spanish Organic Law 16/2015 of October 27th, 2015.

Absent the waiver of sovereign immunity, no asset owned or controlled by a foreign state and allocated to public and official (i.e., non-commercial) purposes can be seized or subject to enforcement proceedings in Spain. This includes assets: (a) used by the diplomatic missions or consular offices of the foreign state for the performance of their duties and functions (including bank accounts, with the exception of accounts exclusively used for commercial purposes); (b) used for military purposes; (c) of the central bank or similar monetary authority of the foreign state and used for the performance of their duties and functions; (d) forming part of the foreign state's cultural heritage or with scientific, cultural or historical interest (with the exception of assets offered for sale); and (e) official vessels and airships, exclusively attached to public services of a non-commercial nature.

10 Licensing

10.1 What are the licensing and other eligibility requirements in your jurisdiction for lenders to a company in your jurisdiction, if any? Are these licensing and eligibility requirements different for a "foreign" lender (i.e. a lender that is not located in your jurisdiction)? In connection with any such requirements, is a distinction made under the laws of your jurisdiction between a lender that is a bank *versus* a lender that is a non-bank? If there are such requirements in your jurisdiction, what are the consequences for a lender that has not satisfied such requirements but has nonetheless made a loan to a company in your jurisdiction? What are the licensing and other eligibility requirements in your jurisdiction for an agent under a syndicated facility for lenders to a company in your jurisdiction?

There is no need for foreign or local lenders or agents under a syndicated facility to be resident, licensed, qualified or entitled to do business in Spain to execute or enforce any rights in Spain under any financing agreements or collateral agreements, provided that, in the case of foreign lenders (and where and if applicable), they are licensed, qualified or entitled to do business in their own jurisdiction of incorporation. Consequently, there is no material distinction between domestic and foreign creditors for the purposes of granting loans or security. Nevertheless, foreign lenders are still subject to some of the abovementioned formalities, such as the obligation to obtain a Spanish tax identification number (*NIF*) (as explained in question 3.13 above).

11 Other Matters

11.1 Are there any other material considerations which should be taken into account by lenders when participating in financings in your jurisdiction?

Most of the relevant issues have already been covered in the previous questions. However, we take the opportunity to point out that the Spanish Companies Act sets out the conditions under which a Spanish company (whether in the form of a public limited liability company (*sociedad anónima*) or in the form of a private limited liability company (*sociedad de responsabilidad limitada*)) may issue and guarantee debt securities.

Because of recent amendments to such law, limited liability companies are now allowed (as opposed to the previous regulations in this regard) to issue and guarantee bonds and other securities that create or recognise debt, except for convertible instruments (i.e., securities which can be converted into equity).

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In the past few years, he has led some of the major Iberian corporate finance transactions, including the debt refinancing of major Spanish listed companies, and has actively participated in international projects within Latin America.

Recommended by several directories, including *Best Lawyers*, *Latin Lawyer*, *IFLR* and *The Legal 500 Latin America* in Banking & Finance and Project Finance, Manuel is a Doctor of Laws (Ph.D.) and a collaborating lecturer at training courses and conferences specialising in finance and corporate law. He has also written several articles on insolvency law and the legal aspects of financing transactions.

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CUATRECASAS

With 1,000 lawyers, Cuatrecasas is present in 12 countries, with a strong focus on Spain, Portugal and Latin America. We advise on all areas of business law, applying a sectoral approach and covering all types of business. We have 16 offices on the Iberian Peninsula and 11 international offices, as well as 5 international desks and 20 country groups, and a close collaboration with leading law firms in other countries. We have a solid track record working side by side with leading companies, advising them on their day-to-day activity and on major transactions. We work with a new approach to client service, combining collective knowledge with innovation and the latest technologies. In 2018, we have been considered the “Most innovative law firm (outside UK)” in the FT Innovative Lawyers Awards. We are also acknowledged by international directories such as Chambers or The Legal 500 as number 1 in the main legal practices.

Our Finance Practice consists of nearly 70 lawyers based in Madrid, Barcelona, Lisbon, New York, London, Mexico City and Bogotá with expert knowledge and extensive experience in complex national and international financial transactions. The lawyers work seamlessly from different locations, ensuring wide coverage for their clients, wherever they are based. The team has extensive expertise advising sponsors and banks in all types of domestic or foreign, corporate and structured, financial and debt capital markets transactions. These transactions include structured and project finance facilities, refinancing, acquisition finance and other types of repackaging, synthetic and mortgaged-backed securitisation, credit assignments, issuance of fixed-interest securities and other financial instruments, as well as consumer credits. We also deal with bankruptcy issues, to ensure the bankruptcy remoteness and appropriate security package structure, extending the scope of our advice to the restructuring of debt. Likewise, we advise on matters and relevant issues related to equity requirements for credit institutions as well as for other entities.

“Ranked as leading firm (Band 1) in Project Finance and Debt Restructuring” (*Chambers & Partners*, 2018).

“Ranked as leading firm (Band 1) in Banking & Finance, Project Finance, Capital Markets and Debt Restructuring” (*The Legal 500*, 2018).

“48 lawyers ranked in Finance practices in Spain” (*Best Lawyers*, 2019).

“European Banking & Finance Deal of the Year” (*The Lawyer*, 2017).

“Americas Awards Deal of the Year: Loans category” (IFLR American Awards, 2017).

Sweden

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1 Overview

1.1 What are the main trends/significant developments in the lending markets in your jurisdiction?

The debt capital markets in Sweden have been very strong during the last couple of years. The local banks remain strong and international banks and financial institutions are showing increasing interest in doing business in Sweden. Competition among lenders is fairly intense as many Swedish blue chip companies have limited need for debt funding due to strong balance sheets and plenty of liquidity. Another development that has increased the competition among debt providers is the development of a substantial and growing Swedish bond market where bonds are issued under local law documentation.

2 Guarantees

2.1 Can a company guarantee borrowings of one or more other members of its corporate group (see below for questions relating to fraudulent transfer/financial assistance)?

The general rule under Swedish law is that a limited company (*Sw. Aktiebolag*) is free to guarantee the obligations of one or more other members of its corporate group, subject to certain restrictions described below under questions 2.2 and 4.1.

2.2 Are there enforceability or other concerns (such as director liability) if only a disproportionately small (or no) benefit to the guaranteeing/securing company can be shown?

A guarantee or security interest granted by a limited company may be invalid and unenforceable if the transaction reduces the company's net worth and cannot be commercially justified (i.e. lacking sufficient corporate benefit). Such a transaction is considered to be a value transfer under Swedish law. A value transfer may only take place if the company's restricted equity is fully covered after the transfer and the transfer can be justified in light of any additional funding requirements that might follow from the company's nature of business as well as the company's consolidation requirements, liquidity and financial position in general. The transaction will be considered to be an unlawful value transfer if these requirements are not fulfilled. In the event of an unlawful value transfer, the recipient of such transfer must return what he or she has received if the company shows that the recipient knew or ought to have realised that the transaction constituted a value transfer from the company.

If a deficiency arises when restitution is made as described above, then those involved in the decision to make the value transfer will be liable for such shortfall. The same applies to those involved in implementing the value transfer. A director can therefore be held responsible for any losses incurred by the company as a result of guarantees and security interests being issued or granted without sufficient benefit for the issuing company.

Granting guarantees and security for wholly owned subsidiaries is typically considered to be commercially justified and therefore not subject to the value transfer restrictions referred to above. However, upstream and cross-stream guarantees and security interests, as well as guarantees and security interests for subsidiaries which are not wholly owned, are sensitive and may not be considered to be commercially justified. The value transfer restrictions may therefore be relevant in case of such guarantees and security interests.

2.3 Is lack of corporate power an issue?

Lack of corporate power is generally not an issue when Swedish companies enter into financing arrangements.

2.4 Are any governmental or other consents or filings, or other formalities (such as shareholder approval), required?

No governmental or other consents or filings are required in order for a Swedish limited liability company to provide guarantees or grant security interests. Shareholder approval is generally not required for granting guarantees and security interests, but may sometimes be advisable, for example in the case of guarantees and security interests granted by companies that are not wholly owned.

2.5 Are net worth, solvency or similar limitations imposed on the amount of a guarantee?

As further described in question 2.2 above, the granting of guarantees and security interests may in certain situations be deemed to constitute value transfers and is as such only allowed if the company's restricted equity is fully covered after the value transfer and the transfer can be justified in light of any additional funding requirements that might follow from the company's nature of business as well as the company's consolidation requirements, liquidity and financial position in general.

Guarantees and security interests granted by an insolvent Swedish company will be subject to clawback risk should the company enter into bankruptcy within certain hardening periods. Any director of an insolvent company that gives preferential treatment to certain creditors of the insolvent company may be held criminally liable as well as liable to pay damages.

2.6 Are there any exchange control or similar obstacles to enforcement of a guarantee?

Sweden has no exchange control provisions or similar obstacles restricting the enforcement of a guarantee issued by a Swedish limited company.

3 Collateral Security

3.1 What types of collateral are available to secure lending obligations?

There are a number of different types of collateral and security interests that can be made available under Swedish law. The most common security interest under Swedish law is the pledge. Under Swedish law, as a general rule, any property or asset can be validly pledged.

3.2 Is it possible to give asset security by means of a general security agreement or is an agreement required in relation to each type of asset? Briefly, what is the procedure?

Swedish law does not recognise the concept of a general security agreement covering all or almost all of the assets of a security provider. Instead, the starting point is that separate security agreements must be entered into in respect of separate assets or separate classes of assets.

Notwithstanding the above, it is possible to grant security over different assets and different types of assets by way of one single security agreement. However, this is often rather impractical, as different perfection and enforcement requirements often apply for different types of assets, which makes all-inclusive security agreements rather extensive and burdensome to draft and apply.

The most common way to take security over assets in general is by way of a floating charge, in accordance with the Floating Charges Act. As described in question 3.9 below, floating charges may be subject to stamp duty.

3.3 Can collateral security be taken over real property (land), plant, machinery and equipment? Briefly, what is the procedure?

The primary means of taking security over real property (i.e. land and buildings and other fixtures thereon) is by way of real estate mortgages. However, such real estate mortgages may, as described in question 3.9 below, be subject to stamp duty, so alternative security arrangements such as share pledges over ring-fenced property companies are also common.

Certain equipment and machinery which is more or less permanently incorporated into a real property can, subject to the prevailing circumstances, be either included in the real property (and thus covered by a real estate mortgage) or be considered as assets which are separated from the real property and therefore can be subject to other security arrangements besides a real estate mortgage.

Collateral can be taken over machinery in a variety of different ways depending on the type of machinery. Machines that are movable goods can be pledged as collateral, but this requires that the movable goods are handed over to the pledgee or to a third party representing the pledgee. If the security provider needs to continue to use the machinery, then a so-called chattel sale (*Sw. lösöreköpsregistrering*) can be made whereby a perfected security interest is created by way of a public announcement followed by a registration with the Swedish Enforcement Authority (*Sw. Kronofogdemyndigheten*).

3.4 Can collateral security be taken over receivables? Briefly, what is the procedure? Are debtors required to be notified of the security?

Security can be taken over receivables and such security is established through a notification of the debtor under the receivable which is subject to such security arrangement. In order for the security interest to be perfected, all payments under the receivables must – as a general rule – be paid to the secured party or to a representative of the secured party. This can sometimes be commercially sensitive as well as administratively onerous at least as regards account receivables. It is therefore quite common with delayed perfection so that the notification of the debtor and the re-direction of payments are only made following a certain credit event relating to the security provider.

It should be noted that relying on delayed perfection (in respect of receivables as well as any other security interests) stands the risk of clawback during certain hardening periods should the security provider file for bankruptcy shortly after the completion of delayed perfection.

3.5 Can collateral security be taken over cash deposited in bank accounts? Briefly, what is the procedure?

Security can be granted over cash deposited in bank accounts. Such security is granted by way of the bank account being pledged to the secured party. It should be noted that Swedish law contains very strict perfection requirements regarding bank account pledges. In order for the pledge to be perfected and enforceable, the pledgor must be deprived of all disposal rights to the bank account. Bank account pledges are therefore not suitable for bank accounts used in the day-to-day activities of the pledgor.

Due to the restrictions set out above, the standard approach in Sweden is to take security over deposit accounts rather than current accounts used for daily business. To the extent that current accounts are pledged, it is common to use delayed perfection arrangements so that the pledgor is only deprived of its disposal rights over the pledged current account following certain credit events. As mentioned above, these type of arrangements stand the risk of clawback during certain hardening periods in case the security provider subsequently enters into bankruptcy proceedings.

3.6 Can collateral security be taken over shares in companies incorporated in your jurisdiction? Are the shares in certificated form? Can such security validly be granted under a New York or English law governed document? Briefly, what is the procedure?

Security over shares is one of the most common security interests in Sweden and is established through a pledge agreement. The perfection requirements for a share pledge depend on whether the shares are represented by physical share certificates or the shares are dematerialised (i.e. in register form). Physical share certificates must be handed over to the secured party or to a third party representing the secured party, whereas dematerialised shares are generally pledged via account entries with the Central Securities Depository as further set out in the Swedish Financial Instruments (Accounts) Act. If the dematerialised shares are held on a custody account, security over the shares is perfected by notifying the custodian appointed in respect of the custody account.

A share pledge agreement in respect of shares in a Swedish limited company does not have to be governed by Swedish law and can, for example, be governed by English or New York law. However, Swedish law would nevertheless as a general rule still apply in respect of perfection requirements. Furthermore, Swedish law contains certain mandatory duty of care provisions that are aimed at protecting a pledgor, for example in connection with a security enforcement. It is therefore advisable that the share pledge agreement is governed by Swedish law and this is also the prevailing market standard.

3.7 Can security be taken over inventory? Briefly, what is the procedure?

As mentioned above under question 3.1, any property or asset can be validly pledged as long as it meets certain criteria. However, in order for an inventory pledge to be perfected and enforceable, the pledgor cannot remain in the possession of the pledged inventory. Inventory pledges are therefore very impractical. A more common way to take security over a floating asset base such as inventory is instead to issue a floating charge as further described in question 3.2 above.

3.8 Can a company grant a security interest in order to secure its obligations (i) as a borrower under a credit facility, and (ii) as a guarantor of the obligations of other borrowers and/or guarantors of obligations under a credit facility (see below for questions relating to the giving of guarantees and financial assistance)?

Yes, please see above under questions 2.1 and 2.2 and below under Section 4 for further details. The restrictions described above in respect of granting of guarantees also apply to the granting of security.

3.9 What are the notarisation, registration, stamp duty and other fees (whether related to property value or otherwise) in relation to security over different types of assets?

No notarisation or registration costs, stamp duties or other fees are payable in relation to the granting of security over receivables and shares.

An application for new real estate mortgages is subject to a stamp duty of two (2) per cent, payable on the face value of such new real estate mortgages. Existing real estate mortgages can, however, be re-pledged an infinite number of times without incurring any additional stamp duty.

An application for new floating charges is subject to a stamp duty of one (1) per cent, payable on the face value of such new floating charges. As with real estate mortgages, existing floating charges can also be re-pledged an infinite number of times without incurring any additional stamp duty.

Finally, it should be noted that minor application fees are payable when applying for new real estate mortgage or floating charges, as well as when applying for a chattel sale or security over certain intellectual property to be registered.

3.10 Do the filing, notification or registration requirements in relation to security over different types of assets involve a significant amount of time or expense?

Most security interests can also be established more or less immediately and there are no significant costs for granting security other than the stamp duty referred to in question 3.9 above.

3.11 Are any regulatory or similar consents required with respect to the creation of security?

There are no such consents required.

3.12 If the borrowings to be secured are under a revolving credit facility, are there any special priority or other concerns?

No, there are not.

3.13 Are there particular documentary or execution requirements (notarisation, execution under power of attorney, counterparts, deeds)?

There are no such requirements.

4 Financial Assistance

4.1 Are there prohibitions or restrictions on the ability of a company to guarantee and/or give security to support borrowings incurred to finance or refinance the direct or indirect acquisition of: (a) shares of the company; (b) shares of any company which directly or indirectly owns shares in the company; or (c) shares in a sister subsidiary?

The restrictions on financial assistance are set out in the Swedish Companies Act. According to the Companies Act, a Swedish limited company may not pay an advance, grant loans or provide security for loans to a borrower (or certain affiliates to such borrower) for the purpose of funding such borrower's acquisition of shares in the company or any parent company in the same group as the company granting the financial assistance.

A Swedish limited company can therefore not support borrowings incurred for the purposes of (a) and (b) in the question above. As regards (c), there is some uncertainty under Swedish law. It is clear that the intention of the legislator has been that such financial assistance shall be forbidden, but the relevant provisions of the Companies Act seem to indicate otherwise. Great caution should therefore be exercised when considering such transactions.

It should be noted that Swedish law provides for some opportunities to grant financial assistance after the completion of an acquisition. Furthermore, there is a regime in the Companies Act whereby exemptions can be granted for otherwise unlawful financial assistance.

5 Syndicated Lending/Agency/Trustee/Transfers

5.1 Will your jurisdiction recognise the role of an agent or trustee and allow the agent or trustee (rather than each lender acting separately) to enforce the loan documentation and collateral security and to apply the proceeds from the collateral to the claims of all the lenders?

Lenders may appoint a facility and/or security agent to represent them in all matters relating to the finance documents as well as any security interests. Such agents are allowed to enforce any rights that the lenders might have under the finance documents. Furthermore, the agent may enforce any collateral security and apply the proceeds from such enforcement in order to satisfy the secured claims of the lenders.

5.2 If an agent or trustee is not recognised in your jurisdiction, is an alternative mechanism available to achieve the effect referred to above which would allow one party to enforce claims on behalf of all the lenders so that individual lenders do not need to enforce their security separately?

Please see question 5.1 above.

5.3 Assume a loan is made to a company organised under the laws of your jurisdiction and guaranteed by a guarantor organised under the laws of your jurisdiction. If such loan is transferred by Lender A to Lender B, are there any special requirements necessary to make the loan and guarantee enforceable by Lender B?

A transfer of a loan is perfected and made valid and enforceable against third parties by way of notification of the debtor under the loan that is being transferred.

A guarantee in respect of a loan obligation will continue to apply and may be called upon by any new lender that has validly acquired the loan that is being guaranteed. The guarantor is sometimes notified of the loan transfer in order to avoid the guarantor fulfilling its guarantee obligation by way of payments to the initial holder of the loans.

6 Withholding, Stamp and Other Taxes; Notarial and Other Costs

6.1 Are there any requirements to deduct or withhold tax from (a) interest payable on loans made to domestic or foreign lenders, or (b) the proceeds of a claim under a guarantee or the proceeds of enforcing security?

Swedish law neither contains an obligation to withhold tax as regards interest payable on loans made to a domestic lender or foreign lender, nor on proceeds of a claim under a guarantee or the proceeds following from an enforcement of security interests.

6.2 What tax incentives or other incentives are provided preferentially to foreign lenders? What taxes apply to foreign lenders with respect to their loans, mortgages or other security documents, either for the purposes of effectiveness or registration?

No tax incentives are provided preferentially to foreign lenders.

No taxes apply to foreign lenders provided that such foreign lenders do not have any permanent establishment in Sweden with which the income from the loan, guarantee or security interest is effectively connected.

6.3 Will any income of a foreign lender become taxable in your jurisdiction solely because of a loan to, or guarantee and/or grant of, security from a company in your jurisdiction?

No, provided that such foreign lender does not have any permanent establishment in Sweden with which the income from the loan, guarantee or security interest is effectively connected.

6.4 Will there be any other significant costs which would be incurred by foreign lenders in the grant of such loan/guarantee/security, such as notarial fees, etc.?

No. Please see question 3.9 above.

6.5 Are there any adverse consequences for a company that is a borrower (such as under thin capitalisation principles) if some or all of the lenders are organised under the laws of a jurisdiction other than your own? Please disregard withholding tax concerns for purposes of this question.

There are no adverse consequences for a Swedish borrower if some or all of the lenders are non-Swedish, as long as such loans are made on market terms and are not made between related parties.

Swedish legislation does not contain any thin capitalisation rules. However, Swedish legislation does contain interest deduction restriction rules on intra-group loan structures including back-to-back structures involving third-party lenders (e.g. banks). These rules apply both for loan structures involving only Swedish companies as well as loan structures involving both Swedish and non-Swedish companies.

7 Judicial Enforcement

7.1 Will the courts in your jurisdiction recognise a governing law in a contract that is the law of another jurisdiction (a “foreign governing law”)? Will courts in your jurisdiction enforce a contract that has a foreign governing law?

The application of foreign law is recognised by Swedish courts, except to the extent that provisions in foreign law are contrary to the *ordre public* (i.e. such provisions that are inconsistent with fundamental principles of the legal system in Sweden).

7.2 Will the courts in your jurisdiction recognise and enforce a judgment given against a company in New York courts or English courts (a “foreign judgment”) without re-examination of the merits of the case?

A final and conclusive judgment rendered by a federal or state court located in the State of New York would in principle neither be recognised nor enforceable in Sweden as a matter of right without a retrial on the merits (but will be of some persuasive authority as a matter of evidence before the courts of Sweden or other public authorities). However, according to Swedish Supreme Court case law, judgments (i) that are based on a jurisdiction clause (the Swedish court may assess whether the jurisdiction clause validly appoints the foreign court), (ii) that were rendered under observance of due process, (iii) against which there lies no further appeal, and (iv) the recognition of which would not manifestly contravene fundamental principles of the legal policy of Sweden, can under certain circumstances form the basis for an identical Swedish judgment without a retrial on the merits.

A final, conclusive and enforceable judgment given by an English court would – pursuant and subject to the provisions of 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) (the "2012 Brussels I Regulation") – be enforceable in Sweden without any declaration of enforceability being required.

Finally, it should be noted that Sweden has acceded to the Convention on the Recognition and Enforcement of Foreign Arbitral Awards, New York, 1958 (the "New York Convention"). A final and conclusive arbitral award, which is enforceable in England or New York and has been duly served on the relevant party, rendered by an arbitral tribunal in England or New York, will be recognised and enforceable by the courts of Sweden, according and subject to the New York Convention and the Swedish Arbitration Act (*Sw. lag (1999:116) om skiljeförfarande*). In order to enforce an arbitral award under the New York Convention in Sweden, the concerned party must submit an application for enforcement (*Sw. exekvatur*) to Svea Court of Appeal (*Sw. Svea hovrätt*) and comply with the procedures of that court (as required).

7.3 Assuming a company is in payment default under a loan agreement or a guarantee agreement and has no legal defence to payment, approximately how long would it take for a foreign lender to (a) assuming the answer to question 7.1 is yes, file a suit against the company in a court in your jurisdiction, obtain a judgment, and enforce the judgment against the assets of the company, and (b) assuming the answer to question 7.2 is yes, enforce a foreign judgment in a court in your jurisdiction against the assets of the company?

If the 2012 Brussels I Regulation applies (see question 7.2 above), a foreign judgment can, upon application, be enforced by the Enforcement Agency more or less immediately if delay places the applicant's claim at risk and the judgment debtor does not apply for refusal of enforcement with the designated district court.

The application for enforcement (*Sw. exekvatur*) of an arbitral award normally takes approximately three to six months.

7.4 With respect to enforcing collateral security, are there any significant restrictions which may impact the timing and value of enforcement, such as (a) a requirement for a public auction, or (b) regulatory consents?

If the pledge agreement has an enforcement clause, the creditor is free to enforce the collateral according to the regime set out in such enforcement clause. Otherwise the creditor may seek enforcement (assuming he has a title of execution) with the Swedish Enforcement Authority. The procedure is governed by the Enforcement Execution Act.

Notwithstanding the above, certain security interests, such as, for example, real estate mortgages and floating charges, can only be enforced through the Swedish Enforcement Authority.

There is a general duty of care obligation under Swedish law whereby a secured party must also look after the interests of the security provider when enforcing security interests. Any excess amounts following such enforcement must also be accounted for and paid out to the security provider.

7.5 Do restrictions apply to foreign lenders in the event of (a) filing suit against a company in your jurisdiction, or (b) foreclosure on collateral security?

If required by an EU or EFTA defendant (i.e. including a Swedish defendant), a foreign plaintiff not domiciled in an EU or EFTA country must furnish security for the legal costs that he might be obliged to pay as a result of the proceedings. By virtue of several multilateral treaties to which Sweden is a party, plaintiffs of a large number of countries have been relieved from the obligation to furnish security.

There are no restrictions for foreign lenders in the event of foreclosure on collateral security.

7.6 Do the bankruptcy, reorganisation or similar laws in your jurisdiction provide for any kind of moratorium on enforcement of lender claims? If so, does the moratorium apply to the enforcement of collateral security?

Yes. Please see question 8.1 below.

7.7 Will the courts in your jurisdiction recognise and enforce an arbitral award given against the company without re-examination of the merits?

Yes. Foreign awards based on an arbitration agreement are recognised and enforced in Sweden. In 1972, Sweden ratified the New York Convention without reservation. Its provisions have been incorporated into Swedish law by the Swedish Arbitration Act. Please see questions 7.2 and 7.3 for further information.

8 Bankruptcy Proceedings

8.1 How does a bankruptcy proceeding in respect of a company affect the ability of a lender to enforce its rights as a secured party over the collateral security?

Following a bankruptcy order, no independent enforcement is, as a general rule, available for secured creditors. However, a creditor that has a valid and perfected possessory pledge (*Sw. handpanträtt*) may sell such collateral at a public auction, subject to such auction not occurring earlier than four weeks after the meeting for administration of oaths. Such creditor must also give the administrator the opportunity to redeem the collateral to the bankruptcy estate.

8.2 Are there any preference periods, clawback rights or other preferential creditors' rights (e.g., tax debts, employees' claims) with respect to the security?

The Swedish Bankruptcy Act states that certain transactions can be made subject to clawback, and thus be recovered to a bankruptcy estate. There are several different circumstances that might give rise to such recovery.

There is a general right to clawback addressing *improper transactions* whereby: a creditor has been preferentially treated; the assets of the debtor have been withheld or disposed of to the detriment of the debtor's creditors in general; or the debtor's total indebtedness has been increased. Such transactions can be recovered if the debtor was insolvent, or became insolvent as a result of the transaction, and the benefitting party was aware, or should have been aware, of the debtor's insolvency and the circumstances making the transaction improper. An improper transaction is subject to a five-year hardening period, and a transaction made more than five years prior to the bankruptcy may only be recovered if the transaction was made to a party closely related to the debtor (e.g. a person who has a substantial joint interest with the debtor based on entitlement to a share or financial interest equivalent thereto, or who through a management position has a decisive influence on the business operations conducted by the debtor).

In addition to the general principle of recovery, there are a number of recovery rules addressing specific types of transactions (e.g. gifts, payment of wages, payment of debts, granting of guarantees or granting of security interests). The majority of the specific rules differ from the general recovery rule in that they do not require the debtor to be insolvent or the benefitting party to have any knowledge of the debtor's insolvency. Furthermore, the hardening periods vary depending on the type of transaction and range between three months and three years.

8.3 Are there any entities that are excluded from bankruptcy proceedings and, if so, what is the applicable legislation?

No. All natural persons and legal entities may be subject to bankruptcy proceedings.

8.4 Are there any processes other than court proceedings that are available to a creditor to seize the assets of a company in an enforcement?

Yes. A creditor that has a title of execution (e.g. judgment, an arbitral award or a summary decision under the Summary Proceedings Act) can seek enforcement with the Swedish Enforcement Authority. The procedure is governed by the Enforcement Execution Act. A decision by the Enforcement Authority may be appealed to the district court.

9 Jurisdiction and Waiver of Immunity

9.1 Is a party's submission to a foreign jurisdiction legally binding and enforceable under the laws of your jurisdiction?

Yes. Swedish law permits that parties agree between themselves to have their disputes adjudicated outside Sweden. The parties are free to choose forum. If the agreement is exclusive it will divest the Swedish court of jurisdiction, at least if a foreign court is willing to hear the case. Where one party is a weaker party, e.g. an employee or a consumer, a jurisdiction clause (i.e. an agreement on forum) which limits such party's access to Swedish courts will be disregarded, at least if the submission to foreign jurisdiction leads to the application of a foreign law which is less favourable to the employee or the consumer (than Swedish law).

9.2 Is a party's waiver of sovereign immunity legally binding and enforceable under the laws of your jurisdiction?

Yes. It is, for example, generally accepted under Swedish law that a valid arbitration clause constitutes a waiver of sovereign immunity.

10 Licensing

10.1 What are the licensing and other eligibility requirements in your jurisdiction for lenders to a company in your jurisdiction, if any? Are these licensing and eligibility requirements different for a "foreign" lender (i.e. a lender that is not located in your jurisdiction)? In connection with any such requirements, is a distinction made under the laws of your jurisdiction between a lender that is a bank *versus* a lender that is a non-bank? If there are such requirements in your jurisdiction, what are the consequences for a lender that has not satisfied such requirements but has nonetheless made a loan to a company in your jurisdiction? What are the licensing and other eligibility requirements in your jurisdiction for an agent under a syndicated facility for lenders to a company in your jurisdiction?

Granting of credit to a company (i.e. not to a consumer) does not in itself require a licence or authorisation under Swedish law, but this may be required in case the lender conducts other types of financial activities as well. A Swedish lender might – even if no licence or authorisation is required – be obliged to notify its activities to the Swedish Financial Supervisory Authority pursuant to the Currency Exchange and Other Financial Operations Act (the "**Financial Operations Act**") and may thereby be subject to certain limited supervision, e.g. in form of ownership assessments. The Financial Operations Act does not apply to non-Swedish entities granting credit to Swedish companies.

There is no specific Swedish regulation applicable to agents or security agents.

11 Other Matters

11.1 Are there any other material considerations which should be taken into account by lenders when participating in financings in your jurisdiction?

The key legal issues to be considered when lending to Swedish entities, and taking security over Swedish assets, have been addressed above.

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Chapter 75

Switzerland

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1 Overview

1.1 What are the main trends/significant developments in the lending markets in your jurisdiction?

The Swiss lending market's demand for credit was mainly driven by M&A activities and commodity trading. The negative interest rates introduced by the Swiss National Bank continued to affect the markets as liquidity generally remained high. Non-bank lenders remained active in the Swiss lending market.

1.2 What are some significant lending transactions that have taken place in your jurisdiction in recent years?

The most significant lending transactions occurred in relation to commodity trading. However, such transactions are usually not publicly known and do not appear in league tables.

2 Guarantees

2.1 Can a company guarantee borrowings of one or more other members of its corporate group (see below for questions relating to fraudulent transfer/financial assistance)?

Yes, a Swiss company can guarantee borrowings of one or more other members of its corporate group. Guarantees are widely used in secured lending transactions. According to Swiss law, a guarantee is a promise to another person that a third party will perform and that the guarantor will compensate for the damages caused as a result of the third party's failure to perform. There are no specific requirements as to the form of the contract. Once validly concluded, the existence of a guarantee is, in principle, independent from the existence of the obligation guaranteed.

2.2 Are there enforceability or other concerns (such as director liability) if only a disproportionately small (or no) benefit to the guaranteeing/securing company can be shown?

Such concerns exist in certain circumstances.

First of all, a director of a Swiss company must act in the interest of the company. Non-compliance with such duty may lead to director liability. Further, Swiss corporate law does not recognise the overall legal concept of integrated company groups. Consequently, the board of directors of a Swiss group company may not take a consolidated view and fulfil its fiduciary duty merely by considering the overall interests of the entire group. It must rather assess and secure the financial status of the Swiss company on an independent and standalone basis, focusing on the company's distinct identity and status as a legally independent corporate entity.

In case the granting of a guarantee leads to so-called 'financial assistance', guarantees might not be enforceable and directors might become liable. Please refer to section 4 (financial assistance).

2.3 Is lack of corporate power an issue?

Yes, please see the answers to question 2.2 above and section 4 below.

2.4 Are any governmental or other consents or filings, or other formalities (such as shareholder approval), required?

Generally no. However, in the case of financial assistance, it is customary practice in Switzerland to require formal approval of upstream or cross-stream guarantees (which potentially qualify as constructive dividends) not only by the board of directors, but also by the shareholders of the Swiss guarantor. Please see the answers in section 4.

2.5 Are net worth, solvency or similar limitations imposed on the amount of a guarantee?

This is the case for financial assistance. Please see the answers in section 4. An upstream guarantee may not be given in an amount exceeding the guarantor's so-called 'free equity'.

2.6 Are there any exchange control or similar obstacles to enforcement of a guarantee?

No, there are not.

3 Collateral Security

3.1 What types of collateral are available to secure lending obligations?

The most common types of collateral in Switzerland are security in the form of a pledge or a transfer of ownership (for security purposes) of real estate, tangible moveable property, financial instruments, claims and receivables, cash and intellectual property.

3.2 Is it possible to give asset security by means of a general security agreement or is an agreement required in relation to each type of asset? Briefly, what is the procedure?

Different types of security can theoretically be contained in a single general security document. In practice, each type of security is usually documented in a separate agreement, particularly if a specific security must be documented in a public deed.

3.3 Can collateral security be taken over real property (land), plant, machinery and equipment? Briefly, what is the procedure?

Yes, collateral security can be taken over real property.

The definition of real estate under Swiss law includes: edified and unedified land (that is, land with or without buildings); a flat or floor of a building; and the right to build on a track of land for a limited period of time (*Baurecht*).

The following forms of security are commonly granted over immoveable property:

Mortgage assignment (*Grundpfandverschreibung*). This is to secure any kind of debt, whether actual, future, or contingent. The creditor of a claim secured by a mortgage assignment can demand an extract from the land register.

Mortgage certificate (*Schuldbrief*). A mortgage certificate establishes a personal claim against the debtor and is secured by a property lien. The mortgage certificate constitutes a negotiable security, which can be pledged or transferred for security purposes and is issued either in bearer form, in registered form or as a paperless version. An outright transfer has certain advantages in case of the security provider's bankruptcy and in multi-party transactions. Therefore, practitioners in cross-border banking transactions often prefer granting an outright transfer of a mortgage certificate instead of a pledge.

In both forms of security, the secured party's claims can be backed by property belonging to the borrower or a third party (third-party security), subject to the rules on financial assistance and similar limitations (see question 2.2 above).

Mortgage assignments and mortgage certificates are created and perfected by the parties entering into an agreement regarding the creation of the security and finalised by means of a notarised deed and an entry into the land register.

3.4 Can collateral security be taken over receivables? Briefly, what is the procedure? Are debtors required to be notified of the security?

Yes, collateral security can be taken over receivables and rights under contracts in general. Common types of claims and receivables over which security is granted are: rights under contracts in general (existing and future); trade account receivables (existing and future); and balances in bank accounts.

Claims and receivables can be pledged or assigned for security purposes. The granting of security is based on the same principles as for security over moveable property (see question 3.7) and, in particular, requires a valid agreement between the security provider and the security holder.

The security agreement must be in writing. There is no transfer of possession. In addition, an assignment of receivables or other claims requires that the assignor sign the assignment itself and not just the related undertaking in the assignment agreement. Perfection of a first-ranking security also requires that the claims or receivables be assignable under the governing law of those claims or receivables.

If a Swiss bank account (that is, the balance of the account standing to the credit of the security provider) is used as collateral, the Swiss bank's business terms usually provide that the bank has a first-ranking security interest over its client's account. A third party therefore only gets a second-ranking security interest over a Swiss bank account, unless the bank waives its priority rights. To create and perfect a second-ranking security interest, the bank must be given notice.

In the case of assignments, the third-party debtors of the receivables are either: immediately notified of the assignment (open assignment (*offene Zession*)); or notified only in case of default of the assignor or other events of default (equitable assignment (*Stille Zession*)).

On notification, the assignee, as the new creditor of the assigned claims, can directly collect the receivables from the third-party debtors. Because Swiss law also allows the assignment of future receivables arising before a potential bankruptcy of the assignor, assignments are commonly used in practice. If all of the present and future trade receivables are taken as security, notice of the creation of the security interest is usually only given to the relevant debtor if there is a default. Until this notification, a *bona fide* debtor can validly discharge its obligation to the security provider.

3.5 Can collateral security be taken over cash deposited in bank accounts? Briefly, what is the procedure?

Yes. See question 3.4 above.

3.6 Can collateral security be taken over shares in companies incorporated in your jurisdiction? Are the shares in certificated form? Can such security validly be granted under a New York or English law-governed document? Briefly, what is the procedure?

Yes, collateral security can be taken over shares in companies incorporated in Switzerland. Shares can be in bearer, registered or dematerialised form. The perfection formalities depend on the form of the shares. Security can be validly granted under a New York or English law-governed document. This is, however, not recommended due to conflict of law issues.

Shares can be pledged, transferred outright and/or assigned for security purposes.

Creation of a security is always based on a valid security agreement. Perfection of a security, however, differs according to the type of shares: certificated shares require possession of the certificates to be transferred to the security holder. Additionally, registered certificates must be duly endorsed and transferred to the security holder. Uncertificated financial instruments must be pledged, transferred or assigned in writing. Since 1 January 2010, the Federal Intermediated Securities Act has set out new rules in relation to intermediated securities (including the granting of security over intermediated securities).

A security over intermediated securities can be granted in one of the following ways: (i) by transferring the intermediated securities to the securities account of the secured party. This requires the security provider to give instructions to the bank to effect the transfer; and (ii) by crediting the intermediated securities to the securities account of the secured party. Alternatively, they can be granted by an irrevocable agreement (a so-called control agreement) between a security provider and its intermediary that the intermediary will comply with any instructions from the secured party. The security provider can, through the control agreement, grant a security right in specified intermediated securities, all intermediated securities in a securities account or a certain quota of intermediated securities in a securities account, determined by value.

3.7 Can security be taken over inventory? Briefly, what is the procedure?

Inventory is a form of tangible moveable property. Tangible moveable property comprises all property that is not classified as immoveable. Security over tangible property is commonly granted in the form of a pledge or an outright transfer.

The pledge is the most widely used type of security. A pledge entitles the lender to liquidate the pledged property if the debtor defaults, and to apply the proceeds in repayment of the secured claims.

In case of an outright transfer, the transferee acquires full title in the transferred assets, but can, under the terms of the transfer agreement, only use its title to liquidate the assets on the debtor's default to apply the proceeds to the repayment of debt. Although the transfer has certain advantages over a pledge on the bankruptcy of a Swiss security provider and in multi-party transactions, its use is restricted by increased liability concerns.

Perfection of a pledge or an outright transfer requires both: a valid security agreement; and the secured party to obtain physical possession of the relevant assets. The security holder does not have a security interest over the collateral as long as the security provider retains possession and control over it (certain moveable property, such as aircraft or ships, is not subject to this principle).

Certain moveable assets are subject to particular rules. The most important are aircraft, ships and railroads where the security is perfected by the entry of the security in the respective register. In addition, the Federal Intermediated Securities Act sets out specific provisions for the granting of a security over intermediated securities.

Swiss law generally does not recognise the concept of a floating charge or floating lien. Therefore, taking a security over inventory, machinery or equipment (often used as collateral in other jurisdictions) is not practical under Swiss law, at least in relation to assets necessary for running the pledgor's business. The requirement of physical control over the relevant assets is generally too burdensome, costly and unmanageable.

3.8 Can a company grant a security interest in order to secure its obligations (i) as a borrower under a credit facility, and (ii) as a guarantor of the obligations of other borrowers and/or guarantors of obligations under a credit facility (see below for questions relating to the giving of guarantees and financial assistance)?

There are no particular company law rules on a Swiss company granting collateral to secure debt used to purchase its own shares or the shares of a parent company or of a subsidiary. The company itself must not purchase more than 10% of its own voting shares.

The granting of security by a Swiss company to secure debt used to purchase its own shares can result in Swiss income tax being levied on the party selling the shares. In addition, the restrictions under corporate benefit rules (see section 4) apply to the granting of any upstream security (for the benefit of a direct or indirect parent company) and/or any cross-stream security (for the benefit of another group company not fully owned by the party providing the security). This is irrespective of the purpose of the secured obligations.

3.9 What are the notarisation, registration, stamp duty and other fees (whether related to property value or otherwise) in relation to security over different types of assets?

The granting or enforcement of a guarantee or security does not in itself trigger any Swiss taxes. However, certain transactions may be subject to Swiss tax.

If loans are secured over real estate, the following fees may be payable depending on the transaction: notaries' fees; registration fees (land register); and cantonal and communal stamp duties. The rates depend on the security's face value and the location of the real estate. The rates for fees vary widely from canton to canton.

3.10 Do the filing, notification or registration requirements in relation to security over different types of assets involve a significant amount of time or expense?

Generally, filing, notification or registration of security interests is done within a couple of days. However, in case of a mortgage over real estate, the notarisation and, in particular, the entry into the land registry might take some time. Similarly, in case of registration of a pledge over intellectual property rights, such registration might take some time.

3.11 Are any regulatory or similar consents required with respect to the creation of security?

Generally, there are no regulatory consents required with respect to the creation of security. In case of a regulated entity granting security over certain of its assets, consents might be required.

3.12 If the borrowings to be secured are under a revolving credit facility, are there any special priority or other concerns?

No, there are not.

3.13 Are there particular documentary or execution requirements (notarisation, execution under power of attorney, counterparts, deeds)?

In case of a mortgage, the mortgage agreement needs to be notarised.

4 Financial Assistance

4.1 Are there prohibitions or restrictions on the ability of a company to guarantee and/or give security to support borrowings incurred to finance or refinance the direct or indirect acquisition of: (a) shares of the company; (b) shares of any company which directly or indirectly owns shares in the company; or (c) shares in a sister subsidiary?

Yes, there are general limitations as to such upstream or cross-stream guarantees or security. The respective limitations apply in relation to guarantees or a security interest that guarantees or secures the finance or refinance of an acquisition of the shares of the company or shares of any company which directly or indirectly owns shares in the company or shares in a sister subsidiary.

Under Swiss law, it is market practice to deal with financial assistance as follows:

So-called upstream or cross-stream guarantees, i.e., guarantees granted to parent or affiliated companies (other than its direct and/or indirect subsidiaries), must generally meet arm's length conditions, as they would be requested by an unrelated third party, such as a bank, when granting the same guarantee. This means, generally, that: (a) the Swiss guarantor should carefully consider the third party's creditworthiness, as well as its willingness and ability to fulfil its obligations that shall be guaranteed; (b) the upstream guarantee should have customary terms of duration, termination and amortisation; (c) the upstream guarantee should provide for adequate interest to be paid regularly (and not just accrued); and (d) the upstream guarantee should be adequately secured (e.g., by the borrower providing a pledge or another form of security).

Non-compliance may notably lead to the invalidity of an upstream guarantee, as well as to directors' and officers' personal liability. Further, non-compliance may have adverse tax implications and may even, under certain conditions, qualify as a criminal offence (e.g., creditor preference or disloyal management) or as a fraudulent conveyance under the applicable provisions of Swiss bankruptcy law.

The following issues should be considered when granting a guarantee:

Corporate purpose: As a general rule, a commitment entered into on behalf of a Swiss company is binding on the company, to the extent it falls within the company's corporate purpose as set forth in the articles of incorporation. If that is not the case, the commitment in question could be deemed *ultra vires* (i.e., beyond the scope of its powers) and thus null and void from the outset. The fulfilment of this prerequisite is often questionable for upstream guarantees which are not entirely on arm's-length terms. In case of doubt, it is advisable for the Swiss guarantor to amend its articles of incorporation by extending the article on corporate purpose to provide explicitly for the granting of financial assistance to group companies, including through upstream guarantees. In addition, it may be advisable to insert in the articles of incorporation a clear reference to the fact that the Swiss guarantor is part of a particular group of companies.

Adequate risk diversification: As a general rule, the board of directors of a Swiss company must adhere to the principle of adequate risk diversification. When granting an upstream guarantee, the board of directors must thus avoid an undue risk concentration by a substantial portion of the company's balance sheet assets consisting of such a guarantee to the benefit of a third party.

Guarantor's free equity: Unless it clearly meets the arm's length test, an upstream guarantee may not be given in an amount exceeding the guarantor's so-called 'free equity'. Free equity corresponds to the amount of the guarantor's total equity (as shown in the statutory balance sheet), minus 150% (or, in the case of a holding company, 120%) of the nominal issued share capital, minus any remaining special reserves which are not available for dividend distributions, such as any special paid-in surplus reserve.

An upstream guarantee exceeding the free equity threshold could be deemed to be an unlawful return of the shareholder's capital contributions and to violate the statutory limitations on the use of the company's legal reserves. As a consequence, such upstream guarantee could be challenged by any party as being null and void from the outset. This is particularly true where the guarantee was fictitious or where it was clear from the beginning that the borrower would not be in a position to fulfil its obligations when due.

Constructive dividend: Under Swiss corporate law, shareholders and related parties are obliged to return any benefits they receive from a Swiss company if those benefits are clearly disproportionate to the consideration received by the company, as well as to its financial status. An upstream guarantee which does not clearly have arm's length terms could be deemed as a constructive dividend. As a consequence, the board of directors of the guarantor would be forced to demand immediate repayment of the guarantee irrespective of its term. Characterisation as a constructive dividend would also lead to adverse tax consequences.

In this context, it has become customary to require formal approval of upstream guarantees (which potentially qualify as constructive dividends) not only by the board of directors, but also by the shareholders of the Swiss guarantor. However, this formal step as such does not necessarily prevent the upstream guarantee from being deemed as a constructive dividend.

Directors' and officers' duty of care: In general, the directors and the senior management of a Swiss company may become personally liable to the company, as well as to its shareholders and creditors, for any damage caused by an intentional or negligent violation of their duties. Such liability may also be incurred by the Swiss company's parent (and its corporate bodies) if the latter is deemed to be a *de facto* corporate body of the Swiss company. In addition, according to the Swiss Withholding Tax Act, directors and officers may become personally as well as jointly and severally liable for unpaid withholding tax obligations of a Swiss company which is liquidated or becomes bankrupt. This liability is stricter than the general directors' and officers' liability insofar as the officers and directors, in order to avoid liability, must prove that they have done everything which could reasonably be expected from them to ascertain and fulfil the company's payable taxes.

Withholding and income tax implications: Ordinary, as well as hidden, profit distributions by resident companies are subject to Swiss withholding tax (currently at 35%) at source. Subject to certain conditions and upon request, the tax may be fully or partially refunded to the recipient of the profit distribution. For non-Swiss recipients, a refund may only be granted based on a double tax treaty between Switzerland and the country of residence of the recipient. Further, profit distributions are not income tax deductible – they are added back to the taxable profit of the distributing company and thus become subject to corporate income tax. From a tax standpoint, a constructive dividend is always assumed when a company executes non-arm's length transactions with related parties. This is also the case with regard to upstream guarantees.

5 Syndicated Lending/Agency/Trustee/Transfers

5.1 Will your jurisdiction recognise the role of an agent or trustee and allow the agent or trustee (rather than each lender acting separately) to enforce the loan documentation and collateral security and to apply the proceeds from the collateral to the claims of all the lenders?

In Switzerland, the agent concept is recognised and frequently used for syndicated facilities and agency arrangements governed by Swiss or foreign law.

As for trustees, a substantive trust law does not exist in Switzerland. Therefore, it is not possible to set up a trust under Swiss law. Since July 2007, the Hague Convention on the Law Applicable to Trusts and on their Recognition 1985 (Hague Trust Convention) is applicable in Switzerland. Certain provisions of the Swiss Private International Law Act (PILA) transpose the Hague Trust Convention into national law. These provisions essentially allow recognition of foreign trusts (as defined in the Hague Trust Convention) in Switzerland. The relevant PILA provisions grant a settlor unfettered freedom to choose the law applicable to the trust. The trust can also contain a choice of jurisdiction, which must be evidenced in writing or in any equivalent form. A Swiss court cannot decline jurisdiction if either a party, the trust or a trustee has their domicile, place of habitual residence or a place of business in the canton of that court or a major part of the trust assets is located in Switzerland.

A decision by a foreign court on trust-related matters is recognised in Switzerland if it is made in any one of the following cases: (i) by a validly selected court; (ii) in the jurisdiction in which the defendant has its domicile, habitual residence or establishment; (iii) in the jurisdiction where the trust has its seat; and (iv) in the jurisdiction whose laws govern the trust. The decision is recognised in the country where the trust has its seat, provided the defendant was not domiciled in Switzerland.

Generally, a security trustee can enforce its rights; however, this depends on the nature of the security:

Pledge: Swiss law is based on the doctrine of accessory (*Akzessorietätsprinzip*), meaning that the secured party must be identical to the creditor of the secured claim. A pledge cannot be vested in a third party acting as a security holder in its own name and right; instead, the pledge must be granted to the lender or, in the case of syndicated loans, all of the lenders as a group. The lender(s) can, however, be represented by a third party acting in the name and on behalf of the lender(s).

Security transfer or security assignment: The doctrine of accessory (see above) does not apply. For this type of security, therefore, a security trustee can enter into the security agreement and hold the security in its own name and on its own account for the lender(s).

Intermediated securities: It is not clear yet whether the doctrine of accessory applies under the Federal Intermediated Securities Act. It is probable that it will not apply where securities are transferred to the secured party's account, but it may apply where a control agreement is entered into.

5.2 If an agent or trustee is not recognised in your jurisdiction, is an alternative mechanism available to achieve the effect referred to above which would allow one party to enforce claims on behalf of all the lenders so that individual lenders do not need to enforce their security separately?

The agent and/or the trust concept is recognised in Switzerland.

5.3 Assume a loan is made to a company organised under the laws of your jurisdiction and guaranteed by a guarantor organised under the laws of your jurisdiction. If such loan is transferred by Lender A to Lender B, are there any special requirements necessary to make the loan and guarantee enforceable by Lender B?

A transfer from Lender A to Lender B is only possible if such transfer is not prohibited under the guarantee. Legally, such transfer will be effected by an assignment.

6 Withholding, Stamp and Other Taxes; Notarial and Other Costs

6.1 Are there any requirements to deduct or withhold tax from (a) interest payable on loans made to domestic or foreign lenders, or (b) the proceeds of a claim under a guarantee or the proceeds of enforcing security?

The granting of security upstream or cross-stream on terms other than arm's length may trigger a 35% dividend withholding tax which must be deducted from the gross payment made.

Dividend withholding tax is fully recoverable if the recipient is a Swiss-resident entity. Non-resident companies with a permanent establishment in Switzerland can claim a full refund, if the relevant asset is attributable to the Swiss permanent establishment. Non-resident companies can claim a full or partial refund of the dividend withholding tax, based on an applicable double tax treaty between their country of residence and Switzerland. If no double tax treaty applies, the dividend withholding tax may become a final burden for the recipient (subject to any measures required in the country of residence of the recipient).

The Swiss Confederation and the cantons or communes levy an interest withholding tax on interest which is secured by a mortgage on Swiss real estate. The combined rate of the tax varies between 13 and 33%, depending on which canton the real estate is located in. This interest withholding tax is reduced to zero under many double tax treaties, including the ones with the US, the UK, Luxembourg, Germany and France.

Further, the transfer of ownership of a bond, note or other securities to secure a claim may be subject to securities transfer stamp tax of up to 0.3%, calculated on the transaction value, if a Swiss bank or other securities dealer as defined in the Swiss stamp tax law is involved as a party or intermediary. The tax is paid by the securities dealer and may be charged to parties who are not securities dealers. If no securities dealer is involved, no transfer stamp tax will arise.

In addition to this stamp tax, the sale of bonds or notes by or through a member of the SIX Swiss Exchange may be subject to a minor SIX Swiss Exchange levy on the sale proceeds.

The sale of goods for consideration in the course of a business is generally subject to VAT. The standard tax rate is currently 8%. Most banking transactions, including interest payments and transactions regarding the granting of security, are exempt from VAT. However, corresponding input taxes on related expenses are not recoverable.

VAT on the sale of real estate is only chargeable if the seller opts for tax. The option is permissible for buildings (but not for land) unless the new owner uses the buildings only for private purposes.

6.2 What tax incentives or other incentives are provided preferentially to foreign lenders? What taxes apply to foreign lenders with respect to their loans, mortgages or other security documents, either for the purposes of effectiveness or registration?

There are no specific incentives of such types and no specific taxes that apply to foreign lenders.

6.3 Will any income of a foreign lender become taxable in your jurisdiction solely because of a loan to, or guarantee and/or grant of, security from a company in your jurisdiction?

Generally, the granting or taking of security between related parties must be at arm's length. This may mean that a security commission or guarantee fee is payable to the security provider. This commission or fee can be subject to income tax for a Swiss security provider as part of his overall earnings. The transfer of ownership of an asset to secure a loan may trigger corporate income taxes on the net income as part of the overall earnings of a Swiss security provider. Income tax rates depend, among other things, on the place of incorporation or residence of a person, entity or permanent establishment.

6.4 Will there be any other significant costs which would be incurred by foreign lenders in the grant of such loan/guarantee/security, such as notarial fees, etc.?

Please see question 3.9.

6.5 Are there any adverse consequences for a company that is a borrower (such as under thin capitalisation principles) if some or all of the lenders are organised under the laws of a jurisdiction other than your own? Please disregard withholding tax concerns for purposes of this question.

No, there are not.

7 Judicial Enforcement

7.1 Will the courts in your jurisdiction recognise a governing law in a contract that is the law of another jurisdiction (a "foreign governing law")? Will courts in your jurisdiction enforce a contract that has a foreign governing law?

Yes. Subject to certain reservations, courts in Switzerland will generally recognise a governing law clause in a contract and will generally enforce a contract that has a foreign law governed contract.

The rules relating to conflicts of law applicable in Swiss courts are set out in the PILA. Generally, a contract is governed by the law chosen by the parties. The choice of law must be expressly and clearly evident from the terms of the contract or the circumstances.

These rules apply to different forms of security in the following ways:

Acquisitions or losses of rights *in rem* in moveable goods. These are governed by the *lex rei sitae*, that is, the law of the country of the asset's location at the time of the event giving rise to that acquisition or loss. The PILA allows the parties to subject the acquisition and loss of those rights to the law governing the underlying legal transaction (see above). However, that choice of law cannot be invoked against third parties who can rely on the *lex rei sitae*.

Outright transfers of a claim and/or of uncertificated securities are effected by way of security. These assignments are subject to the law (PILA) chosen by the parties or governing the claim, in the absence of a choice. However, that choice of law cannot be invoked against the debtor of the claim and the issuer of uncertificated securities without the debtor's prior consent.

Pledges of securities and debts. If the parties have not chosen the applicable law, the pledge of securities and debts is not governed by the *lex rei sitae* but by the law of the pledgee's domicile. (However, if the parties make a choice of law, it cannot be invoked against third parties (see above).) Irrespective of the law applicable between the parties, the only law which can be invoked against the issuer of a security or the debtor of a claim is the law governing the pledged security or right.

Specific rules apply to intermediated securities. The law applicable to dispositions over intermediated securities, as well as further rights to such intermediated securities, is the law chosen by the parties to the relevant account agreement (Hague Convention on Intermediated Securities). However, this law can only apply if the relevant intermediary has an office (as described in the Hague Convention on Intermediated Securities) in that jurisdiction at the time the agreement is entered into. Otherwise, the applicable law is the law of the jurisdiction in which the intermediary's office, with which the relevant account agreement was entered into, is located.

7.2 Will the courts in your jurisdiction recognise and enforce a judgment given against a company in New York courts or English courts (a "foreign judgment") without re-examination of the merits of the case?

A final judgment obtained in New York or English courts is amenable to recognition and enforcement in the courts of Switzerland according to (i) the Convention on Jurisdiction and Enforcement of Judgments in Civil and Commercial Matters dated 30 October 2007, (ii) such other international treaties under which Switzerland is bound, or (iii) PILA, provided that the prerequisites of the Lugano Convention, such other international treaties or the PILA, as the case may be, are met.

7.3 Assuming a company is in payment default under a loan agreement or a guarantee agreement and has no legal defence to payment, approximately how long would it take for a foreign lender to (a) assuming the answer to question 7.1 is yes, file a suit against the company in a court in your jurisdiction, obtain a judgment, and enforce the judgment against the assets of the company, and (b) assuming the answer to question 7.2 is yes, enforce a foreign judgment in a court in your jurisdiction against the assets of the company?

In case the guarantor is in possession of a so-called '*Rechtsöffnungstitel*', i.e. if the debtor recognised in a written document that it owes the amount to the guarantor, the guarantor's rights might get enforced in summary proceedings which may take two to three months. In the more likely case that no such '*Rechtsöffnungstitel*' is available, the guarantor will have to go through normal court proceedings. A judgment might be rendered within one year (first instance).

The latter is true also in case (b) if a foreign judgment needs to be enforced.

7.4 With respect to enforcing collateral security, are there any significant restrictions which may impact the timing and value of enforcement, such as (a) a requirement for a public auction, or (b) regulatory consents?

Under Swiss law, it is possible that in the security agreement the parties mutually agree that a pledgee take over the pledge in case of enforcement ('*Selbsteintritt*') and/or that the pledgee is entitled to sell the pledge ('*Privatverwertung*'). In case there is no such agreement and/or in case of formal bankruptcy proceedings, the enforcement of collateral will take place by public auction in accordance with the Swiss procedural rules. The Swiss bankruptcy law foresees several different timelines depending on the type of collateral (moveables, real estate, etc.).

7.5 Do restrictions apply to foreign lenders in the event of (a) filing suit against a company in your jurisdiction, or (b) foreclosure on collateral security?

No, they do not.

7.6 Do the bankruptcy, reorganisation or similar laws in your jurisdiction provide for any kind of moratorium on enforcement of lender claims? If so, does the moratorium apply to the enforcement of collateral security?

Generally, in the case of bankruptcy, pledged assets form part of the bankrupt estate. As a result, the private enforcement of pledged assets is no longer permitted and enforcement can only occur according to the Debt Enforcement Act. Intermediated securities traded on a representative market are not subject to this restriction, and private enforcement remains possible.

The pledgee's priority rights remain effective, and the proceeds from the sale of the pledged assets in the bankruptcy proceedings are first used to cover the claims secured by the pledge. If the proceeds from the sale of the pledged assets exceed those secured claims, the surplus is available for distribution to other creditors.

All claims against the bankrupt company become due at the time the bankruptcy is declared and the enforcement of all claims occurs in accordance with the procedures prescribed by the Debt Enforcement Act.

As to moratorium, Swiss law provides for company rescue procedures (*Nachlassverfahren*) in the Debt Enforcement Act. The rescue proceedings can be started by the company or in certain circumstances by a company's creditor. In those proceedings, the competent court can grant a moratorium (*Nachlassstundung*). A moratorium may, if certain conditions are fulfilled, lead to a composition agreement (*Nachlassvertrag*) that is binding on all creditors and affects the creditors' unsecured claims. For a composition agreement to be effective, it must be approved by at least a majority of the creditors holding two-thirds of all the debts or a quarter of the creditors holding three-quarters of the debt, and the competent bankruptcy court.

If a moratorium is granted by the competent court, the security granted by the company is not directly affected. However, as a rule, enforcement proceedings for the security cannot be started or continued as long as the moratorium is in effect. Private enforcement (see question 8.4) should still be possible and not be affected by a moratorium. If the rescue proceedings result in a composition agreement, the security granted by the company will not be affected by this. A composition agreement does not affect security granted by the company.

7.7 Will the courts in your jurisdiction recognise and enforce an arbitral award given against the company without re-examination of the merits?

An arbitration award rendered against a Swiss company in an arbitration proceeding is generally enforceable in Switzerland according and subject to the New York Convention of 10 June 1985 on the recognition and enforcement of foreign arbitral awards.

8 Bankruptcy Proceedings

8.1 How does a bankruptcy proceeding in respect of a company affect the ability of a lender to enforce its rights as a secured party over the collateral security?

All claims against the bankrupt company – as well as claims resulting from a guarantee – become due at the time the bankruptcy is declared and the enforcement of all claims occurs in accordance with the procedures prescribed by the Debt Enforcement Act.

8.2 Are there any preference periods, clawback rights or other preferential creditors' rights (e.g., tax debts, employees' claims) with respect to the security?

The Debt Enforcement Act provides, in connection with bankruptcy and composition of a security provider, that a transaction is voidable if any of the following apply:

The security provider or the guarantor disposes of assets for free or for inadequate consideration (not at arm's length) in the year before the adjudication of bankruptcy or an equivalent event.

The security provider repays debts before they become due, settles a debt by an unusual means of payment or grants collateral for previously unsecured liabilities, which the security provider was not obliged to secure, in the year before the adjudication of bankruptcy or an equivalent event, provided that both the security provider was overindebted (i.e., its liabilities exceeded its assets) at that time and the secured party was aware of the overindebtedness of the security provider. A *bona fide* secured party is therefore protected. However, the law presumes the secured party's knowledge of the security provider's overindebtedness, so the secured party bears the burden of proof in relation to his good faith.

The granting of security by the security provider (or the granting of the guarantee) occurred in the five years before the adjudication of bankruptcy proceedings or an equivalent event, provided that the security provider intended to disadvantage or favour certain creditors or should reasonably have foreseen that result and the security provider's intent was, or must have been, apparent to the secured party.

8.3 Are there any entities that are excluded from bankruptcy proceedings and, if so, what is the applicable legislation?

Under Swiss law, it is not possible to start debt enforcement proceedings against Swiss municipalities (*Gemeinden*) with the aim of inducing bankruptcy. In accordance with the applicable ordinance on debt enforcement, only enforcement proceedings on the enforcement of collateral are possible against Swiss municipalities.

8.4 Are there any processes other than court proceedings that are available to a creditor to seize the assets of a company in an enforcement?

The conditions under which security (including guarantees) can be enforced are determined by general principles of law, as well as by the specific provisions of the security agreement. This applies to loans, guarantees, pledged assets and assets transferred by way of security. For a secured party to be permitted to enforce security, the secured party must have a secured claim, and this claim must be due. The relevant security agreement may set out additional conditions for the enforcement of the security. Usually, security agreements refer to the occurrence of an event of default, as specified in the credit agreement governing the secured loan, as a condition for enforcing the security.

Guarantees under Swiss law are basically independent from the underlying claim. Therefore, it is not a requirement for the enforcement of a guarantee that an underlying claim must exist or be due (in contrast to pledges). It is sufficient that the conditions for enforcement set out in the guarantee are fulfilled. However, depending on the circumstances, the enforcement of a guarantee where there is no underlying claim may constitute an abuse of rights, which is not protected under Swiss law.

In the case of pledged assets, there are two main forms of enforcement, namely by way of a private enforcement and under the rules of the Debt Enforcement Act. Private enforcement is generally only permitted where the parties have agreed to this in advance; for example, in the security agreement. Private enforcement is possible in relation to all forms of assets, but in practice mainly occurs in connection with moveable assets. Private enforcement can take place by a private sale or a public auction or, in relation to assets, the value of which can be objectively determined (for example, listed securities), the pledgee itself purchasing the pledged assets, and applying the proceeds to its claims (*Selbsteintritt*). For securities over intermediated securities, as a matter of law, private enforcement does not need to have been agreed between the parties but is only permitted in respect of intermediated securities that are traded on a representative market. Pledges over intermediated securities can also be enforced privately on the bankruptcy of the security provider. This is in contrast to pledges over any other assets.

In all forms of private enforcement, the pledgee must protect the interests of the pledgor and, in particular, must obtain the best price possible in the sale of the pledged assets, fully document the enforcement and provide the documentation to the pledgor and return any surplus remaining after the application of the proceeds to the secured debt to the pledgor.

9 Jurisdiction and Waiver of Immunity

9.1 Is a party's submission to a foreign jurisdiction legally binding and enforceable under the laws of your jurisdiction?

Basically, yes.

9.2 Is a party's waiver of sovereign immunity legally binding and enforceable under the laws of your jurisdiction?

A sovereign entity either acts with its so-called administrative assets or with its financial assets. Administrative assets are the assets that directly serve the administrative tasks of an administration. Financial assets do not directly serve such purpose. If a sovereign entity is entering into an agreement concerning its financial assets, it may validly waive sovereign immunity, because in such cases the sovereign entity is acting as a normal third party. In the case of administrative assets, a sovereign entity may also waive sovereign immunity; however, in extreme cases (e.g. public policy issues) such waiver might be doubtful.

10 Licensing

10.1 What are the licensing and other eligibility requirements in your jurisdiction for lenders to a company in your jurisdiction, if any? Are these licensing and eligibility requirements different for a "foreign" lender (i.e. a lender that is not located in your jurisdiction)? In connection with any such requirements, is a distinction made under the laws of your jurisdiction between a lender that is a bank *versus* a lender that is a non-bank? If there are such requirements in your jurisdiction, what are the consequences for a lender that has not satisfied such requirements but has nonetheless made a loan to a company in your jurisdiction? What are the licensing and other eligibility requirements in your jurisdiction for an agent under a syndicated facility for lenders to a company in your jurisdiction?

No, there are no licensing or eligibility requirements in Switzerland for a lender to a company. Any person can lend to a third party. Lending is not an activity that requires a licence. However, given that lending is typically an activity done by a bank, it is noteworthy that the banking business does require a licence, even if it does not perform the lending activity. A bank that is not domiciled in Switzerland and does not have any physical presence in Switzerland is entitled to do banking activities on a cross-border basis into Switzerland, which includes the lending business. Note that Swiss law will change and such cross-border exemptions will no longer be possible without a licence. The change in law will occur by 1 January 2020.

11 Other Matters

11.1 Are there any other material considerations which should be taken into account by lenders when participating in financings in your jurisdiction?

No, there are not.

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Taiwan

Hsin-Lan Hsu

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1 Overview

1.1 What are the main trends/significant developments in the lending markets in your jurisdiction?

The escalation and uncertainty of the trade war between America and China drags on in the global economy in 2018. According to Bloomberg's statistics, the total loan amount in 2018 slightly decreased compared to the total loan amount in 2017. This is the same as the situation in 2017, as the interest rate is still low; currently, many Taiwanese companies look for loan funding from individual banks, commercial paper and bond offerings instead of syndication loans, which has made the syndication loan market relatively inactive in 2018. Also, the syndication loan transactions that are being made are small in size.

In order to stimulate economic growth and drive industrial transformation, the Taiwanese government approved the Special Act for Forward-Looking Infrastructure in July 2017. The Forward-Looking Infrastructure Development Program (2017–2024) will expand investments in major infrastructure (including railways, aquatic environments, green energy, digital technology, and urban and rural facilities). The government investment in this large-scale infrastructure programme will total NT$882.49 billion (US$28.56 billion), and is expected to spur public and private enterprise investment of NT$1.78 trillion (US$57.53 billion).

Among the infrastructure projects, green energy is being invested in the most, especially wind-powered energy plans. The government has set a target of installing 5.5GW of offshore wind power capacity by 2025. The green energy drive will provide promising financing opportunities for Taiwanese banks in the next few years.

Due to such green energy policy, the Financial Supervisory Commission ("FSC") has positioned green finance as one of the most important policies and encouraged domestic funds to invest in the green energy industry. The implemented measures of green finance include: (1) assisting the green energy industry in obtaining financing; (2) guiding insurance industry capital to be channelled into investment in domestic public construction, including the green energy industry; (3) providing diverse channels for fund raising and obtaining financing; and (4) enhancing green finance talent nurturing. The FSC has also publicly pledged to support facilitating private sector investments in offshore wind farms.

Based on such policy-oriented support and assistance, several significant syndicated loan cases in relation to investments in offshore wind farms have taken place or are currently under discussion. For example, the first syndicated loan for the offshore wind farm has been closed and utilised in June 2018. It was reported that, in December 2018, Ørsted has selected three local lenders as lead banks to arrange a syndicated loan to finance its offshore wind projects in Taiwan. Furthermore, for the projects to be completed in 2020 or 2021, the relevant developers have selected the lead banks or prepared the financial term sheets in order to target the utilisation by the end of 2019.

1.2 What are some significant lending transactions that have taken place in your jurisdiction in recent years?

(1) In May 2018, Advanced Semiconductor Engineering secured a five-year syndicated loan for NT$90 billion (US$3 billion) from a banking consortium comprising 39 domestic and foreign financial institutions led by Bank of Taiwan and Mega International Commercial Bank. The loan is to be used for the acquisition of Siliconware Precision Industries Co Ltd. It was reported that the syndicated loan closed 230% oversubscribed, attracting NT$210 billion (US$7 billion) in total, exceeding the original target of NT$90 billion.

(2) On June 7, 2018, Formosa I Wind Power Co., Ltd. signed a syndicated loan for NT$18.5 billion (US$616.7 million) with 11 domestic and foreign banks. The loan is to be used for development and construction of the first Taiwan offshore windfarm.

(3) On June 28, 2018, AU Optronics Corp. ("AUO") secured a total of NT$42 billion (US$1.4 billion) facility with Bank of Taiwan as the facility agent. According to a local news release, the syndicated loan closed 319% oversubscribed, attracting NT$111.7 billion (US$3.91 billion) in total, exceeding the original target of NT$35 billion. AUO will use the new funds to repay its existing debts.

(4) On October 11, 2018, King Yuan Electronics signed a five-year syndicated loan for NT$14.2 billion (US$458.5 million) with Mega International Commercial Bank as the facility agent. It was reported that the syndicated loan closed 210% oversubscribed, attracting NT$25 billion (US$1.326 billion) in total, exceeding the original target of NT$12 billion. This syndicated loan is to refinance its debt and bolster its operating capital.

(5) On November 8, 2018, United Renewable Energy, Taiwan's vertically integrated solar manufacturer, entered into a NT$10.13 billion (US$338 million) syndicated loan agreement with First Commercial Bank as the facility agent. It was reported that this syndicated loan is for a period of three years and can be extended for another two years.

(6) On January 14, 2019, Winbond Electronics secured a seven-year syndicated loan for NT$42 billion (US$1.4 billion) from a banking consortium led by Bank of Taiwan. It was reported that the syndicated loan closed 193% oversubscribed. The loan is to be used for development and construction of a new plant and purchase of the machinery and equipment.

2 Guarantees

2.1 Can a company guarantee borrowings of one or more other members of its corporate group (see below for questions relating to fraudulent transfer/financial assistance)?

According to the Company Act, no company can act as a guarantor of any nature, unless otherwise permitted by law or by the company's Articles of Incorporation. Thus, if permitted by its Articles of Incorporation, the company may provide guarantees for other members of its corporate group.

If the company is a public company, there will be additional restrictions. Pursuant to the Regulations Governing Loaning, Endorsement or Guarantees of Public Companies ("Guarantee Regulation"), a public company may provide guarantees only for the following companies: (1) a company with which the public company conducts business; (2) a company in which the public company directly and indirectly holds more than 50% of the voting shares; and (3) a company that directly and indirectly holds more than 50% of the voting shares in the public company. In addition, a guarantee provided by a public company should comply with the internal rules adopted in accordance with the Guarantee Regulation.

2.2 Are there enforceability or other concerns (such as director liability) if only a disproportionately small (or no) benefit to the guaranteeing/securing company can be shown?

Generally, there is no concern about the enforceability under this circumstance so long as all legal requirements are satisfied. However, if a company provides guarantees for others for only a disproportionately small benefit or without benefit in return in the absence of a justifiable cause, there may be concern that the directors resolving the guarantees may breach their fiduciary duties. Further, the creditors of the guarantor may apply to the court to revoke the guarantee if, due to the guarantee, the guarantor does not have sufficient assets to repay the debts owed to its creditors.

2.3 Is lack of corporate power an issue?

Please refer to our answer to question 2.1. If a company's Articles of Incorporation do not permit the company to provide guarantees to others, but the company's responsible person, such as a director, still provides guarantees to others on behalf of the company, the responsible person alone should be liable for the guarantees. The guarantee does not constitute a valid obligation of the company.

2.4 Are any governmental or other consents or filings, or other formalities (such as shareholder approval), required?

No governmental approval is required for a company to provide guarantees. As for due authorisation, a board resolution adopted by the board of directors of the company to provide guarantees normally would suffice, unless the Articles of Incorporation provide otherwise. In practice, however, it is not common for a company's Articles of Incorporation to require that the provision of guarantees be approved by a shareholders' meeting.

However, where a Taiwanese company provides a guarantee to its overseas affiliate (incorporated in a jurisdiction other than Mainland China) who borrows funds to make investment in Mainland China, the guarantor will require a prior approval of the Investment Commission ("IC"), the MOEA with respect to investment in Mainland China.

2.5 Are net worth, solvency or similar limitations imposed on the amount of a guarantee?

The Guarantee Regulation and a company's internal rules adopted in accordance therewith impose certain limitations on the aggregate amount of the company's guarantees to all counterparties and the amount of the company's guarantees to a single counterparty. If the internal rules are incorporated into the company's Articles of Incorporation, the violation of the internal rules and the Articles of Incorporation by the company in providing a guarantee may affect the enforceability of the guarantee. By contrast, if the company only violates the internal rules in providing the guarantee, it is generally considered that violation of such limitations will only result in an administrative fine imposed by the Financial Supervisory Commission or breach of fiduciary duty by the directors, but will not affect the enforceability of the guarantees.

2.6 Are there any exchange control or similar obstacles to enforcement of a guarantee?

A Taiwanese corporate entity or individual has an annual foreign exchange quota of US$50 million (or its equivalent) or US$5 million (or its equivalent), respectively. No prior approval from the CBC is required if the Taiwanese onshore guarantor converts New Taiwan Dollars into foreign currency for remittance to the offshore creditor and the conversion does not exceed the above quota. The CBC has the sole discretion to grant or withhold its approval on a case-by-case basis if the onshore Taiwanese guarantor's quota would be exceeded for such conversion.

3 Collateral Security

3.1 What types of collateral are available to secure lending obligations?

Among other things, the following types of collateral are commonly seen in secured lending transactions:

(1) a mortgage over real property, such as land and buildings;

(2) a chattel mortgage over a movable asset, such as machinery and equipment;

(3) a pledge over movable assets or securities, or a pledge over the pledgor's property rights which are transferable, such as the pledgor's rights in bank accounts, accounts receivable or patents; and

(4) an assignment of property rights, which are transferable.

3.2 Is it possible to give asset security by means of a general security agreement or is an agreement required in relation to each type of asset? Briefly, what is the procedure?

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 without identifying the specific asset, such as a floating charge, is not enforceable under Taiwanese law. In addition, different types of assets may be subject to different requirements, such as registration or filing with the competent authorities, on the perfection of the security. We will briefly advise on such requirements in our answers to questions 3.3 to 3.7.

3.3 Can collateral security be taken over real property (land), plant, machinery and equipment? Briefly, what is the procedure?

Yes. In order to create a valid mortgage over the land, buildings and plants, the mortgagor and the mortgagee should enter into a written agreement, and a registration with the competent authority is required.

As for machinery and equipment, the security to be created may be a pledge or a chattel mortgage. Both security interests (pledge and chattel mortgage) 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 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, registration with the competent authority is necessary in order for the mortgagee to claim the chattel mortgage against a *bona fide* third party.

3.4 Can collateral security be taken over receivables? Briefly, what is the procedure? Are debtors required to be notified of the security?

Yes. 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 in order for the pledgee to be able to claim the pledge against the obligor.

3.5 Can collateral security be taken over cash deposited in bank accounts? Briefly, what is the procedure?

Yes. To create a pledge over cash deposits, the pledgee and the pledgor must enter into a written agreement. The pledge shall not become effective against the account bank taking the cash deposits unless the account bank is notified of the creation of the pledge. Nevertheless, please note that the concept of a floating charge is not recognised under Taiwanese law. In other words, the pledge covers only the cash in the bank account when such pledge is created and notified to the bank at which the account was opened. The pledge will not cover the cash deposited in the bank account after the account bank is notified of the pledge. To deal with this issue, the pledgor, in practice, will be required to periodically confirm with the account bank the amount of cash in the bank account to ensure that the pledge also covers the cash deposited after the creation of the pledge.

3.6 Can collateral security be taken over shares in companies incorporated in your jurisdiction? Are the shares in certificated form? Can such security validly be granted under a New York or English law-governed document? Briefly, what is the procedure?

Yes. According to the Company Act, a pledge could be created over the shares in a Taiwanese company. A private Taiwanese company may determine at its discretion whether it will issue share certificates to its shareholders, and if yes, the share certificates will be in certificated or scripless form. On the other hand, a public company is obligated to issue share certificates to its shareholders.

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 in order to register such 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. However, the creation of the pledge cannot be claimed against the company unless the company is notified of the creation of the pledge.

To create a pledge over shares in scripless forms which are transferred through the book-entry system of Taiwan Depository and Clearing Corporation ("TDCC"), the pledgor and the pledgee have to sign a form prescribed by the TDCC and have the pledge registered with the TDCC.

A pledge over shares can also be created based upon the document governed by New York or English law, as long as the creation and perfection of the pledge follow the procedures and requirements described above.

3.7 Can security be taken over inventory? Briefly, what is the procedure?

A floating charge over the inventory is not enforceable under Taiwanese law. Please refer to our answer to question 3.2.

3.8 Can a company grant a security interest in order to secure its obligations (i) as a borrower under a credit facility, and (ii) as a guarantor of the obligations of other borrowers and/or guarantors of obligations under a credit facility (see below for questions relating to the giving of guarantees and financial assistance)?

(i) Yes, it can.

(ii) This issue is whether a company may provide guarantees for others. Please refer to our answer to question 2.1.

3.9 What are the notarisation, registration, stamp duty and other fees (whether related to property value or otherwise) in relation to security over different types of assets?

No notarisation or stamp duty is required for the creation of security over different types of assets, mentioned in our answer to question 3.1. The registration fee for creating a chattel mortgage over a movable asset is NT$900. The registration fee for creating a mortgage over real property is equivalent to 1/1,000 of the total amount secured by the mortgage.

3.10 Do the filing, notification or registration requirements in relation to security over different types of assets involve a significant amount of time or expense?

Regarding the registration fee, please refer to our answer to question 3.9. The authority in charge of the registration will only conduct a formality review and it is not expected that the registration will take a significant amount of time.

3.11 Are any regulatory or similar consents required with respect to the creation of security?

In addition to the requirement of registration for certain types of security interests as mentioned above, generally the creation of the security interests does not require a regulatory or similar consent.

However, it is worth noting that, before the amendment of the Company Act on August 1, 2018 which took effect from November 1, 2018, a foreign company which has not been recognised by the Taiwan competent authorities and has not accordingly established a branch in Taiwan has no capacity to act as a security interest holder. Since the amendment to the Company Act last year, a foreign company is not required to be recognised and set up a branch in Taiwan in order to have the same legal capacity as a local company and thus legally speaking should be able to act as a security interest holder unless otherwise provided by law. However, according to a ruling issued by the Ministry of Interior dated December 17, 2018, the foreign company who wishes to obtain a real estate mortgage as security still needs to register and have a branch in Taiwan. Although there is no similar ruling in connection with chattel mortgage, it is likely that the authority in charge of the chattel mortgage would adopt the same approach as the Ministry of Interior and request that a foreign company who wishes to obtain a chattel mortgage as security still needs to register and have a branch in Taiwan.

3.12 If the borrowings to be secured are under a revolving credit facility, are there any special priority or other concerns?

Take a real property mortgage, for example. The mortgage can be divided into a general mortgage and a maximum amount secured mortgage. As for a general mortgage, the obligations to be secured should exist upon the creation of the mortgage. Otherwise, the mortgage will be held unenforceable. By contrast, a maximum amount secured mortgage is to secure the obligations created and owed to the mortgagee for a period of time. So long as the secured obligations exist at the end of the mortgage period, the mortgagee may foreclose the real property. Since the obligations under a revolving credit facility may arise and be satisfied from time-to-time according to the borrower's drawdown and repayment, the mortgage to secure such obligations should be a maximum amount secured mortgage instead of a general mortgage. The above also applies to a chattel mortgage and a pledge.

3.13 Are there particular documentary or execution requirements (notarisation, execution under power of attorney, counterparts, deeds)?

No, there are not.

4 Financial Assistance

4.1 Are there prohibitions or restrictions on the ability of a company to guarantee and/or give security to support borrowings incurred to finance or refinance the direct or indirect acquisition of: (a) shares of the company; (b) shares of any company which directly or indirectly owns shares in the company; or (c) shares in a sister subsidiary?

Regarding the prohibitions and restrictions on the provision of guarantees by a company, please refer to our answer to question 2.1. The provision of security other than a guarantee generally will be deemed as providing a guarantee as well, and is subject to the same prohibitions and restrictions.

In addition, according to the Company Act, a company cannot redeem or buy back any of its outstanding shares unless otherwise permitted by law. For instance, a company may purchase up to 5% of its outstanding shares and transfer the same to its employees. To give another example, a listed company may buy back its outstanding shares in the circumstances permitted under the Securities and Exchange Act. The restriction on a company's ability to buy back its outstanding shares extends to the company's controlled company; in addition, the violation of such restriction may cause the buy-back to be void. A subsidiary of the parent company cannot purchase the shares of the parent company. Nevertheless, the Company Act does not prohibit a sister subsidiary from purchasing the shares of another sister subsidiary if the other sister company, together with its parent company, does not directly or indirectly hold more than 50% of the sister company.

5 Syndicated Lending/Agency/Trustee/Transfers

5.1 Will your jurisdiction recognise the role of an agent or trustee and allow the agent or trustee (rather than each lender acting separately) to enforce the loan documentation and collateral security and to apply the proceeds from the collateral to the claims of all the lenders?

As a general practice for a syndicated loan, syndicated banks will appoint an agent bank to act for and on behalf of the syndicated banks, including registering the agent bank as, for instance, a mortgagee and foreclosing the mortgaged property. In addition, there will be a clause in the syndicated loan agreement to the effect that the syndicated banks' claims against the borrower under the syndicated loan agreement are joint and several. Given this, the agent bank may claim the whole amount of the loan from the borrower and distribute the proceeds obtained therefrom to the syndicated banks in accordance with their proportion of participation in the loan.

Nevertheless, under Taiwan law, it is questionable whether or not a third party, who is not a creditor/lender, could validly hold the collateral as a trustee or a security agent for other creditors/lenders. Pursuant to the Civil Code, a mortgage/pledge would not be validly created in favour of the creditor/mortgagee/pledgee if there is no underlying credit owned by the mortgagee/pledgee against the debtor.

5.2 If an agent or trustee is not recognised in your jurisdiction, is an alternative mechanism available to achieve the effect referred to above which would allow one party to enforce claims on behalf of all the lenders so that individual lenders do not need to enforce their security separately?

As advised in question 5.1 above, in practice, if the lenders' claims against the borrowers are joint and several, one of the lenders may be appointed as the agent bank by syndicated banks to act for and on behalf of all the syndicated banks, including registering the agent bank as, for instance, a mortgagee and foreclosing the mortgaged property.

5.3 Assume a loan is made to a company organised under the laws of your jurisdiction and guaranteed by a guarantor organised under the laws of your jurisdiction. If such loan is transferred by Lender A to Lender B, are there any special requirements necessary to make the loan and guarantee enforceable by Lender B?

The transfer of the loan from Lender A to Lender B will not be effective against the borrower and the guarantor until either Lender A or Lender B has notified the borrower and the guarantor of such transfer.

6 Withholding, Stamp and Other Taxes; Notarial and Other Costs

6.1 Are there any requirements to deduct or withhold tax from (a) interest payable on loans made to domestic or foreign lenders, or (b) the proceeds of a claim under a guarantee or the proceeds of enforcing security?

(a) For a domestic non-bank lender, who is a Taiwan resident or a profit-seeking enterprise with a fixed place of business in Taiwan, the withholding tax rate for interest is 10% but such withholding tax is applicable to corporate borrowers only. Individual borrowers are not required to withhold tax on interest.

For a foreign lender, who 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%, but if the interest derives from short-term commercial papers, securitised instruments, government/corporate/financial institution bonds, or conditional transactions, the withholding tax is 15%. Moreover, most of the tax treaties provide a reduced income tax withholding rate of 10%. Taiwan has signed tax treaties with 32 jurisdictions; namely, Australia, Austria, Belgium, Canada, Denmark, France, Gambia, Germany, Hungary, India, Indonesia, Israel, Italy, Japan, Kiribati, Luxembourg, Macedonia, Malaysia, the Netherlands, New Zealand, Paraguay, Poland, Senegal, Singapore, Slovakia, South Africa, Swaziland, Sweden, Switzerland, Thailand, the United Kingdom and Vietnam.

(b) Where the portion of the proceeds is to indemnify the principal of the loan made by the lender, it will not be subject to income tax. If the portion of the proceeds is to indemnify the default interest sustained by the lender, it may be subject to income tax as mentioned above. Moreover, in the event that the proceeds include a penalty pursuant to an agreement between the lender and the borrower, such penalty will be subject to income tax unless the lender may prove that the penalty is to indemnify losses suffered by the lender.

6.2 What tax incentives or other incentives are provided preferentially to foreign lenders? What taxes apply to foreign lenders with respect to their loans, mortgages or other security documents, either for the purposes of effectiveness or registration?

(1) Income tax on the following categories of income shall be exempted:

- Interest derived from loans offered to the Taiwanese government or legal entities within the territory of Taiwan by foreign governments or international financial institutions for economic development, and interest derived from the financing facilities offered to their branch offices and other financial institutions within the territory of Taiwan by foreign financial institutions.
- Interest derived from loans extended to legal entities within the territory of Taiwan by foreign financial institutions for financing important economic construction projects under the approval of the Ministry of Finance.
- Interest derived from favourable-interest export loans offered to or guaranteed for the legal entities within the territory of Taiwan by foreign governmental institutions and foreign financial institutions which specialise in offering export loans or guarantees.

Moreover, some of the tax treaties provide an exemption from income tax withholding for interest payment. For example, the Netherlands-Taiwan Tax Treaty provides that the interest which is paid in respect of a bond, debenture or other similar obligations of a Taiwanese public entity, or of a subdivision or local authority of Taiwan, should be taxed only in the Netherlands.

(2) For the purposes of effectiveness or registration, there is no tax applicable to foreign investments, loans, mortgages or other security documents.

6.3 Will any income of a foreign lender become taxable in your jurisdiction solely because of a loan to, or guarantee and/or grant of, security from a company in your jurisdiction?

No, a foreign lender (except for a foreign entity's Taiwan branch) will not be subject to Taiwan income taxes solely because of a loan to or guarantee and/or grant of security from a Taiwanese company.

6.4 Will there be any other significant costs which would be incurred by foreign lenders in the grant of such loan/guarantee/security, such as notarial fees, etc.?

Please refer to our answer to question 3.9.

6.5 Are there any adverse consequences for a company that is a borrower (such as under thin capitalisation principles) if some or all of the lenders are organised under the laws of a jurisdiction other than your own? Please disregard withholding tax concerns for purposes of this question.

A thin capitalisation rule was incorporated into the Income Tax Act effective from January 28, 2011. That is, retroactively from January 1, 2011, if the ratio of a company's debts (to its related party) to its equity exceeds a certain ratio, the interest expense arising out of the portion of the debts exceeding said ratio is not deductible, except for financial institutions (including banks, cooperatives, financial holding companies, bills finance companies, insurance companies, and securities firms). The Ministry of Finance, by referring to international practices, has set a safe harbour debt-equity ratio of 3:1.

The same treatment in respect of the thin capitalisation rule applies to both domestic and foreign lenders.

7 Judicial Enforcement

7.1 Will the courts in your jurisdiction recognise a governing law in a contract that is the law of another jurisdiction (a "foreign governing law")? Will courts in your jurisdiction enforce a contract that has a foreign governing law?

Generally, the choice of a foreign governing law to govern a contract 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 such courts hold that: (i) the application of such provisions would be contrary to the public order or good morals of Taiwan; or (ii) such provisions would have the effect of circumventing mandatory and/or prohibitive provisions of Taiwan law. However, where the contract is about the creation/perfection of a security interest, such as a pledge and mortgage, the choice of law will be subject to the conflicts of law of Taiwan.

7.2 Will the courts in your jurisdiction recognise and enforce a judgment given against a company in New York courts or English courts (a "foreign judgment") without re-examination of the merits of the case?

Any final judgment rendered by a foreign court shall be recognised and enforceable in Taiwan without review of the merits, provided that the court of Taiwan in which the enforcement is sought is satisfied that:

(i) the foreign court rendering the judgment has jurisdiction over the subject matter according to Taiwan law;

(ii) the judgment and the court procedures resulting in the judgment are not contrary to the public order and good morals of Taiwan;

(iii) if a default judgment was entered into against the losing party, the losing party was (a) duly served within a reasonable period of time within the jurisdiction of such court in accordance with the laws and regulations of such jurisdiction, or (b) process was served upon the losing party with the judicial assistance of Taiwan; and

(iv) judgments of the Taiwan court are recognised by the foreign court on a reciprocal basis.

To our knowledge, there is reciprocity for enforcement of judgments between Taiwan and New York/England.

7.3 Assuming a company is in payment default under a loan agreement or a guarantee agreement and has no legal defence to payment, approximately how long would it take for a foreign lender to (a) assuming the answer to question 7.1 is yes, file a suit against the company in a court in your jurisdiction, obtain a judgment, and enforce the judgment against the assets of the company, and (b) assuming the answer to question 7.2 is yes, enforce a foreign judgment in a court in your jurisdiction against the assets of the company?

(a) Depending on the complexity of the case in dispute, it could take half a year to one year or longer for each of the district court, the high court and the Supreme Court to render a judgment. Regarding the enforcement of the final judgment against the assets of the company, it also depends on the value and types of the company's assets. For example, to foreclose a mortgaged real property, it may take from several months to one year or longer to conduct the auctions for the real property if there is no bidder or if the bid price is below the set auction price.

(b) Depending on whether the Taiwan court or the counterparty has raised any objections to the elements set forth in our answer to question 7.2, it may take months or one year or longer for the Taiwan court to render a judgment recognising the foreign judgment. In addition, as mentioned in point (a) above, the enforcement of a final judgment against the assets of the company depends on the value and types of the company's assets.

7.4 With respect to enforcing collateral security, are there any significant restrictions which may impact the timing and value of enforcement, such as (a) a requirement for a public auction, or (b) regulatory consents?

(a) Depending on the types of collateral security, foreclosure of collateral security through a court proceeding may require a public auction. For instance, if the real property is foreclosed through a court proceeding, the court will designate an expert to assess the value of the real property and hold a public auction to sell it. If the real property has not been sold due to the fact that no bidder attended the auction or the bidding price is below the auction price set by the court, the court will have to reduce the auction price and repeat similar exercises to sell the real property in accordance with the Mandatory Execution Act. Accordingly, foreclosing the real property may take longer through a public auction than by other means of enforcement such as a private agreement between the mortgagor and the mortgagee to settle debts by transferring ownership of the real property to the mortgagee.

(b) Generally, no regulatory consent is required in order for the security interest holder to enforce the collateral interest.

7.5 Do restrictions apply to foreign lenders in the event of (a) filing suit against a company in your jurisdiction, or (b) foreclosure on collateral security?

(a) Generally, no. However, according to the Code of Civil Procedure, if a plaintiff has no domicile, office, or place of business in Taiwan, the court shall, by a ruling on motion filed by the defendant, order the plaintiff to provide a security for the litigation expenses. Such requirement will not apply in cases where either the portion of the plaintiff's claim is not disputed by defendant or the plaintiff's assets in Taiwan are sufficient to compensate the litigation expenses.

(b) Please refer to our answer to question 3.11.

7.6 Do the bankruptcy, reorganisation or similar laws in your jurisdiction provide for any kind of moratorium on enforcement of lender claims? If so, does the moratorium apply to the enforcement of collateral security?

Regarding bankruptcy, all enforcement actions against the debtor will be stayed by the bankruptcy of the debtor and all unsecured creditors must follow the bankruptcy proceeding administered by the court to file their claims against the debtor. Nevertheless, if a creditor, such as a lender, has a mortgage, pledge or right of retention over the debtor's assets, the lender may enforce such collateral security without going through the bankruptcy proceeding.

As for reorganisation, all enforcement actions against the debtor subject to reorganisation will be stayed no matter whether the lender is a secured (such as a mortgagee or a pledgee) or unsecured creditor. The lender may not foreclose the collateral security regardless of other stakeholders and should follow the reorganisation proceeding administered by the court.

7.7 Will the courts in your jurisdiction recognise and enforce an arbitral award given against the company without re-examination of the merits?

According to the Arbitration Law, a foreign arbitration award would be recognised and enforceable by the courts of Taiwan without reviewing the merits, provided that none of the following exist:

(i) where the recognition or enforcement of the arbitral award is contrary to the public order or good morals of Taiwan; or

(ii) where the dispute is not arbitrable under the laws of Taiwan.

In addition, if there is no reciprocity in the recognition and enforcement of an arbitral award between Taiwan and the country in which the arbitral award is made or the country whose arbitration rules are applicable, the Taiwanese court may dismiss the petition for the recognition of a foreign arbitral award.

8 Bankruptcy Proceedings

8.1 How does a bankruptcy proceeding in respect of a company affect the ability of a lender to enforce its rights as a secured party over the collateral security?

Please refer to our answer to question 7.6 regarding foreclosure of the collateral interest by a lender. In addition, if a lender's claims cannot be fully satisfied by foreclosing the collateral security, the lender may still participate in the bankruptcy proceeding as an unsecured creditor to seek possible repayment.

8.2 Are there any preference periods, clawback rights or other preferential creditors' rights (e.g., tax debts, employees' claims) with respect to the security?

There are no preference periods with respect to the security. The bankruptcy administrator may, within six months of the bankruptcy adjudication, apply to the court for the invalidation of the following acts of the debtor: (1) provision of security for outstanding debts within six months prior to the bankruptcy adjudication; and (2) repay the debts not yet due. In addition, the bankruptcy administrator shall, within two years after declaration of the bankruptcy proceeding, file with the court to rescind the transaction which the bankrupt conducted with or without consideration before the bankruptcy proceeding if such transaction is deemed detrimental to the rights of the bankrupt's creditor and is revocable under the Civil Code.

As for preferential creditors' rights, below are certain examples:

(i) land value increment tax, land value tax and house tax levied on the sale of the real property which will rank prior to the mortgagee and the unsecured creditors;

(ii) the following labour claims will rank prior to unsecured creditors: (a) labour wages due and payable by the employer but overdue for a period of fewer than six months; (b) retirement payments payable by the employer pursuant to the Labour Standards Act but not yet paid; and (c) severance payable by the employer pursuant to the Labour Standards Act or Labour Pension Act but not yet paid; and

(iii) fees and debts incurred for the benefit of the bankruptcy estate which will rank prior to unsecured creditors.

8.3 Are there any entities that are excluded from bankruptcy proceedings and, if so, what is the applicable legislation?

The following may apply for bankruptcy adjudication: (1) natural persons; (2) juristic persons; and (3) partnerships and any other incorporated association with a representative or an administrator. An unincorporated association without a representative or administrator is excluded from a bankruptcy proceeding, and there is no special legislation applicable to such entity. Banks and insurance companies are excluded from bankruptcy proceedings and will be subject to the proceedings provided under the Banking Act, Deposit Insurance Act and Insurance Act.

8.4 Are there any processes other than court proceedings that are available to a creditor to seize the assets of a company in an enforcement?

According to the Civil Code, the creditor may initiate certain self-help remedies to seize the debtor's property and will not be liable therefor, provided that: (i) the assistance of the court or of other relevant authorities is not accessible in time and the satisfaction of the creditor's claim will be impossible or manifestly difficult without the self-help remedy; and (ii) the creditor shall apply for the court's assistance immediately after the self-help remedy is exercised. A creditor and the security provider may sign an agreement whereby the ownership of the mortgaged or pledged security will be transferred to the mortgagee or pledgee automatically when the debtor defaults. However, in the case of a mortgaged security, such agreement to transfer cannot be enforced against a *bona fide* third party, unless the mortgage is registered with the competent authorities.

9 Jurisdiction and Waiver of Immunity

9.1 Is a party's submission to a foreign jurisdiction legally binding and enforceable under the laws of your jurisdiction?

The Judicial Yuan of Taiwan has held an internal conference and reached a conclusion that a submission to jurisdiction clause will be valid in the absence of any of the following circumstances: (1) it would be unfair for the subject matter to be adjudicated by the chosen jurisdiction; (2) the consent of a party to submit to the chosen jurisdiction was obtained by fraud, duress or other unlawful means; (3) the parties were not equal-footed when they entered into the submission to jurisdiction agreement; (4) it would be inappropriate or inconvenient for the chosen jurisdiction to adjudicate the subject matter; and (5) the country of the chosen jurisdiction does not recognise and enforce judgments of Taiwan courts on a reciprocal basis. The conclusion made by the Judicial Yuan is, however, subject to test in court.

9.2 Is a party's waiver of sovereign immunity legally binding and enforceable under the laws of your jurisdiction?

Yes, it is. It will be binding upon that party under Taiwan law unless (i) the waiver would be contrary to the public order or good morals of Taiwan, or (ii) the waiver would have the effect of circumventing mandatory and/or prohibitive provisions of Taiwanese law.

10 Licensing

10.1 What are the licensing and other eligibility requirements in your jurisdiction for lenders to a company in your jurisdiction, if any? Are these licensing and eligibility requirements different for a "foreign" lender (i.e. a lender that is not located in your jurisdiction)? In connection with any such requirements, is a distinction made under the laws of your jurisdiction between a lender that is a bank *versus* a lender that is a non-bank? If there are such requirements in your jurisdiction, what are the consequences for a lender that has not satisfied such requirements but has nonetheless made a loan to a company in your jurisdiction? What are the licensing and other eligibility requirements in your jurisdiction for an agent under a syndicated facility for lenders to a company in your jurisdiction?

There is no particular licensing or other eligibility requirement to lend money to a company in Taiwan. However, the Company Act provides that the capital of a Taiwanese company shall not be lent to any person unless the lending arrangement is due to business transaction or is necessary for short-term financing and the aggregate amount of such short-term financing should not exceed 40% of the company's net value. As a result, in local practice, no company in Taiwan except banks, securities firms, insurance companies or pawn shops may engage in lending as an ordinary business. Taiwan has not opened the establishment and operation of lending/finance companies. Accordingly, currently it is not possible to set up a company to operate a lending business in Taiwan.

Since there is no particular licensing or eligibility requirement, the main distinction under the laws of Taiwan between a lender that is a bank *versus* a lender that is a non-bank, would be the application of the above lending restriction under the Company Act to a non-bank lender.

There is no particular licensing or other eligibility requirement or restriction on a foreign lender for making a loan to Taiwanese borrowers outside of Taiwan, regardless of whether the foreign lender is licensed or not. Nevertheless, a foreign company is not allowed to operate any business in Taiwan without setting up a branch in Taiwan. Thus, if lending is the foreign company's business, making a loan to Taiwanese borrowers by the foreign company which does not have a branch in Taiwan on a repeated and continuous basis may violate the Company Act. Furthermore, as advised in our answer to question 2.6, in the case of a foreign loan to a Taiwanese borrower, the foreign exchange control would apply unless such foreign debts have been registered with the CBC by the Taiwanese borrower.

There are no licensing and other eligibility requirements in Taiwan for an agent under a syndicated facility for lending to a company in Taiwan. However, in practice, an agent is normally a member of the syndication and the credit rights of the syndication members are joint and several in order to allow the agent to claim the repayment/payment and the collateral on behalf of the other syndication members.

11 Other Matters

11.1 Are there any other material considerations which should be taken into account by lenders when participating in financings in your jurisdiction?

For foreign lenders who will participate in financing in Taiwan, please refer to our answer to question 3.11 regarding the ability of a foreign entity without a local presence to take collateral security, especially the real estate mortgage and chattel mortgage.

If a foreign lender provides a loan with a term of more than one year to a Taiwanese company in which it owns shares or capital, or a Taiwanese partnership in which it is one of the partners, or a Taiwanese business of which it is the sole proprietor or a branch created by it, please note that a prior approval from the Investment Commission of the MOEA is required.

As to foreign exchange control, please refer to our answer to question 2.6.

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United Arab Emirates

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1 Overview

1.1 What are the main trends/significant developments in the lending markets in your jurisdiction?

Trends

Based on our observations, as well as feedback from bankers, financiers and market leaders, the lending market in the UAE recovered slightly in 2018, with the annual value of loans increasing by an average of 3.075% per month. Annual loan growth in December 2018 was 4.8% (the highest rate for any month in the year) after the same figure was a record low of 1.7% in December 2017. From an Islamic finance perspective, many leading Islamic banks and financial institutions, including Dubai Islamic Bank, Emirates Islamic Bank and Abu Dhabi Islamic Bank, announced increased profits in 2018 largely due to increased income from fees, financing and investment transactions and the reduction of provisions for impairment charges. Dubai Islamic Bank, Emirates Islamic Bank and Abu Dhabi Islamic Bank increased their net profit in the first nine months of 2018 by 12.1%, 31.7% and 3.5% respectively. The asset-based nature of asset financing is well suited to the principles of Islamic financing, and there is a growing trend of *Shari'a*-compliant financing in the aviation, shipping and infrastructure industries. Ijara arrangements are often used to replicate conventional lease agreements, providing a viable *Shari'a*-compliant alternative to conventional aircraft and shipping financing. Istisna' contracts are also useful in circumstances where aircraft are purchased directly from the manufacturer and the financing is put in place before such aircraft are delivered. In addition, we have witnessed and are witnessing tangible interest by Islamic financial institutions in gaining exposure to asset-backed or asset-based lending in non-Islamic jurisdictions including the United States of America, the United Kingdom, and the European Union. We are also witnessing an increase in the utilisation of parallel Islamic funding structures with conventional funds based in the United States of America that are investing in various types of real estate, ranging from post offices, hotels, offices, and industrial units. Such funds are looking to the region to tap the liquidity in the market, whilst being mindful of the intricacies of *Shari'a* compliance.

However, market volatility continues in part caused by the geo-political and energy-related events of 2018, such as the ongoing severance of ties with Qatar by some GCC countries, including the UAE, and Brent crude hitting a four-year high in October 2018 at USD 86 per barrel only to tumble to USD 50 per barrel by December 2018. This market volatility has inspired caution from banks and other loan market participants – in particular in the project finance space, we have seen many of the financial institutions shy away from long tenors, with export credit agencies and development institutions stepping up to play a larger role in the financing of major projects in the region. Consistent with this trend, we have also seen a return of mini-perm and equity bridge loans structures in project financings as well as project bonds – we expect these trends to continue in 2019. In addition, a slowdown in GDP and population growth in the UAE means that market participants are expecting modest growth in their loan portfolios in 2019 – on the one hand, credit is tightening as caution dominates local financial institutions' approach to credit, and on the other, UAE financial institutions enjoy large amounts of liquidity which needs to be deployed although investment grade borrowers are not borrowing in sufficient amounts. Finally, whilst UAE banks are well capitalised, the cost of funding increased in 2018 as EIBOR pushed higher and the UAE Central Bank raised its benchmark interest rates by 25 basis points to 2.75% imitating the hike made by the US Federal Reserve. The trend in the benchmark for 2019 will depend on a number of local and international factors, such as the US Federal Reserve rate, oil prices and geo-political circumstances.

Background to legal regime

When reading this chapter, it is important to note that the UAE provides the option for companies to incorporate either 'onshore' (for which 51% of the company must be owned by a UAE national or 100% by a Gulf Cooperation Council ("GCC") national) or 'offshore' (in one of over 40 free zones, including, but not limited to, the Dubai International Financial Centre ("DIFC") and the Abu Dhabi Global Market ("ADGM")). However, Federal Decree by Law No. 19 of 2018 regarding Foreign Direct Investment ("FDI Law") promulgated on 30 October 2018, permits 100% foreign direct ownership of onshore UAE companies operating in certain sectors of the economy. This has been a strategic move to prioritise growth in those sectors. However, it should be noted that Article 7 of the FDI Law contains a 'negative list' of sectors which are excluded and remain subject to the original 49%/51% ownership thresholds. These sectors include, but are not limited to, the exploration and production of petroleum materials, military sectors and banking and finance. As most free zones will only have the power to regulate and promulgate laws regarding the incorporation of companies, each free zone typically has its own companies laws and regulations. These laws and regulations permit 100% foreign ownership in their respective free zone. The focus of this chapter will be on onshore UAE companies and companies incorporated in the DIFC and ADGM (as the DIFC and ADGM are the most relevant free zones insofar as financial institutions and their activities are concerned). Both the DIFC and ADGM have enacted comprehensive laws and regulations (in many cases imported from English law) but excluding criminal law as the Federal Penal Code 3 of 1987 (as amended) still applies to such free zones. In addition, the DIFC and ADGM have their own court system.

Practitioners should also be aware that *Shari'a* (Islamic law) is the main source of legislation as confirmed by Article 6 of the Constitution of the UAE 1971, as amended ("UAE Constitution"). The UAE Constitution was amended on 27 March 2004 to allow the establishment of financial free zones (the DIFC and ADGM by way of example) and grants them the legislative power to enact their own civil and commercial laws for the companies registered within those free zones. Nevertheless, any companies operating, lending or taking security in the UAE should be sensitive to UAE law and customs. A key example of this relates to the language used in *Shari'a* compliant transaction documentation. Terms such as "lender", "borrower", "debt" and "loan", although used within this chapter to assist the reader, are not *Shari'a*-compliant and should be interpreted as (and used when working on *Shari'a*-compliant deals) "financier", "obligor", "facility" or "financing", as applicable.

Legislation

The introduction of value added tax ("VAT") at a rate of 5% across the UAE as of 1 January 2018 has also made an impact on the economy, boosting the nation's revenue alongside projections of a modest 1.7% rise in GDP. The VAT regime was enacted pursuant to Federal Decree Law No. 8 of 2017, (the "VAT Law"), based on the principles contained in the Unified GCC Agreement for VAT, which was published in the Kingdom of Saudi Arabia's Official Gazette in April 2017.

In 2016, Federal Decree by Law No. 9 of 2016 on bankruptcy (the "Bankruptcy Law") came into effect, introducing the UAE's first standalone bankruptcy legislation. The Bankruptcy Law has introduced restructuring and standardised insolvency procedures in the UAE. In addition, the Bankruptcy Law applies across the board to companies governed by the Commercial Companies Law (Federal Law No. 2 of 2015 concerning Commercial Companies) (the "CCL 2015"), some free zone companies, sole establishments and civil companies conducting professional business.

The Bankruptcy Law has also introduced three main procedures for a business in financial difficulty: a protective composition; a restructuring scheme; and insolvency and liquidation. The implications of the Bankruptcy Law on the lending market in the UAE are touched upon in this chapter, particularly with regards to the rights of secured creditors in enforcing their security interests during bankruptcy proceedings. The Bankruptcy Law has given support to companies experiencing economic difficulty by providing different routes through which such companies can continue as a going concern and avoid liquidation.

In late 2016, Federal Law No. 20 of 2016 on the pledge of moveables as security for debt (the "Pledge Law") was enacted. However, the Security Register (as defined below) was not established until April 2018. This is a significant new legislative development which substantially changes or regularises the manner in which a charge can be created over moveable assets. The Pledge Law provides lenders with the ability to register effective pledges over tangible or intangible moveable assets that exist in the present or in the future, a problem both lenders and debtors have struggled with for some time.

The Pledge Law changes the position of taking a pledge over moveable assets by removing the need to transfer the possession to the mortgagee or third party as bailee. A new electronic security register (the "Security Register") has been established to record the rights of the parties under the pledge and to establish priority *vis-à-vis* competing creditors. The removal of the need to take possession over the asset has been a welcome modernisation of the law, which removes an administrative burden for commercial parties and encourages uninterrupted trading in the assets that are secured. This has been significant in situations where a transfer of possession was not practical or possible. The Pledge Law has had a positive reception; however, due to the untested nature of the same, we have seen circumstances where parties have erred on the side of caution and have chosen to both take security under the Pledge Law, as well as other available forms of security (where possible) to secure their positions.

Further detail on the practical effect and operation of the Pledge Law is clarified by the executive regulations, Pledge Law (Council of Ministers Decree No. 5 of 2018, the "Executive Regulations"). The Pledge Law has provided greater confidence to both lenders and borrowers in the UAE lending market, and the Executive Regulations provide detailed guidance on the practicalities and documents needed for security registration.

The DIFC also recently introduced a number of new laws and regulations enhancing its corporate regulatory framework. Significant changes were established by the the new DIFC companies law (DIFC Law No. 5 of 2018) (the "New DCL"), which came into effect on 12 November 2018. One important change is the reclassification of companies, whereby 'Limited Liability Companies' are now either categorised as 'Public Companies' or 'Private Companies'. Alongside the New DCL, new companies' regulations, ultimate beneficial ownership regulations, investment company regulations, new DIFC operating laws and regulations, and protected cell company regulations were enacted, bringing more transparency and certainty into the free zone which is expected to be attractive to foreign investors looking to invest in the region.

1.2 What are some significant lending transactions that have taken place in your jurisdiction in recent years?

The AED 397,500,000 senior project facilities made available by Dubai Islamic Bank PJSC in April 2018 to Reem Integrated Healthcare Holdings, for the development of the Al Reem Integrated Health & Care Center in Abu Dhabi. The 10-year facility was split as an AED 280,000,000 Istisna/forward lease, AED 87,500,000 Ijarah and an AED 30,000,000 profit rate swap. The transaction reflects a trend in project financing where risk aversion from financial institutions translated into a highly structured deal, with a subordinated mezzanine financing tranche with Tor Asia Credit Master Fund LP as Mezzanine Creditor (among others) and a second ranking facility with Al Tamouh Investments Company LLC as Vendor Creditor which were brought in to cover the equity gap. It also highlights the increasing investment in healthcare projects in the UAE.

The USD 400,000,000 project bond coordinated by Citigroup and HSBC issued in November 2018 for the refinancing of debt linked to the Fujairah 1 (F1) IWP project, a fully operational power and desalinated water plant in the Emirate of Fujairah, with Abu Dhabi Water and Electricity Company (ADWEC) as offtaker.

The Abu Dhabi Future Energy Company PJSC and Sharjah Environment Company LLC Waste to Energy project. The project is innovative as it is the first Waste to Energy project to be financed on a non-recourse basis in the Middle East region and the first long-term project financing in the Emirate of Sharjah. The debt financing of USD 164,000,000 was made available by Abu Dhabi Commercial Bank, Abu Dhabi Fund for Development, Siemens Bank, SMBC and Standard Chartered and it closed in December 2018. It was structured as a 20-year door-to-door soft mini-perm with a target refinancing date at Year 2 post Scheduled Project Commercial Operation Date and a minimum Debt Service Coverage Ratio of 1.20×.

The USD 1,500,000,000 financing in April 2018 of the Mohammed bin Rashid Al Maktoum Solar Park Phase 4 by Chinese banks

ICBC, Bank of China and Agricultural Bank of China, which will see a heavy presence from Chinese contractors, including Shanghai Electric, Dongfang Electric and Harbin Electric. The deal was structured as a seven-year soft mini-perm loan. The Mohamed bin Rashid Al Maktoum Solar Park is the largest thermo-solar power plant in the world.

2 Guarantees

2.1 Can a company guarantee borrowings of one or more other members of its corporate group (see below for questions relating to fraudulent transfer/financial assistance)?

A company can generally guarantee the borrowings of members of its corporate group in the UAE, subject to certain restrictions as set out in the response to question 4.1.

For both onshore and offshore entities, authority to provide guarantees is predominantly governed by the relevant entity's constitutional documents and obtaining the relevant corporate authorisations (see the response to question 2.3). Guarantees must be in writing and specify the amount secured by the guarantee.

Generally, guarantees provided under certain Islamic financing structures that are subject to *Shari'a* principles may not be permitted, if their objective is to guarantee a specified return to the lenders or investors. The purpose of the guarantee must be clearly defined from the outset as per the laws of the UAE. Further, all documents relating to a *Shari'a*-compliant transaction must be pre-approved in writing by *Shari'a* scholars who issue compliance certificates (each, a Fatwa and collectively, Fatawa) per transaction and are expected to audit the transaction on a regular, often annual, basis to ensure that it continues to comply with *Shari'a* and its requirements, as interpreted by the relevant *Shari'a* scholars and documented in the relevant Fatwa.

2.2 Are there enforceability or other concerns (such as director liability) if only a disproportionately small (or no) benefit to the guaranteeing/securing company can be shown?

Whilst no specific restrictions are identifiable, the main concern revolves around a director's fiduciary duties to the relevant company.

Onshore

A director of an onshore company in the UAE is required to act in the company's best interests, as set out in the CCL 2015.

The directors of an onshore company must have regard to the legislative requirement for the pursuit of profit (CCL 2015 Article 8), and to further the company's objectives (CCL 2015 Article 22). With those interests in mind, there are also some distinct provisions to which directors should adhere, including a restriction on guaranteeing any loan agreement with a board member and third party (CCL 2015 Article 153) and entering into any loan agreements (typically interpreted as including guarantees) for a term that exceeds three years (CCL 2015 Article 154) (see the response to question 2.3).

Offshore

Similarly, free zone entities place similar responsibilities on the directors. The New DCL states that directors must, amongst other things, "exercise independent judgment, exercise reasonable care, skill, and diligence and avoid conflicts of interest" (New DCL Articles 71, 72 and 73 respectively). In relation to the ADGM, Chapter 2 of the ADGM Companies Regulation 2015 (the "ADGM Company Regulations") also requires that directors perform the same duties listed above in the New DCL. The New DCL is widely considered to have broadened the scope of duties for directors of DIFC companies and both the New DCL and the ADGM Company Regulations closely align with the directors' duties under the English Law Companies Act 2006.

Directors for both onshore and offshore companies should therefore take care when committing a company to guarantee the financial risk of another entity, and should conduct appropriate due diligence to ensure that the company is able to meet its payment obligations and that the company is not insolvent or likely to become insolvent.

2.3 Is lack of corporate power an issue?

Similar to the Western markets, the first step for both onshore and offshore companies is to review their constitutional documents to ensure that the company can provide a guarantee.

Onshore

By way of its constitutional documents, an onshore company may grant management with broad powers that enable it to run the company without involving its board of directors and shareholders (subject to certain restrictions for public companies – explored in more detail below).

In respect of onshore public joint stock companies ("PJSC"), directors may not enter into a loan agreement (which is interpreted by most practitioners and based on most court rulings to include guarantees) for a term that exceeds three years (CCL 2015 Article 154), unless the constitutional documents expressly permit this. If not expressly permitted, shareholder approval should be obtained. For onshore limited liability companies ("LLCs"), which had previously avoided hefty regulation, directors should be aware that CCL 2015 now includes an article (Article 104) that states that the provisions therein, which apply to PJSC and private joint stock companies ("PrJSC"), shall now also apply to an LLC unless otherwise stated. On 29 April 2016, the UAE Ministry of Economy published Ministerial Resolution No. 272 of 2016 (the "Resolution"). The Resolution seeks to clarify which provisions regarding PJSCs also apply to LLCs. Although the Resolution clarified many provisions in the CCL, one example being that managers of LLCs can now be held liable to the LLC and/or its shareholders for 'errors in management' (which need not be gross errors), certain provisions remain unaddressed, for example, whether Article 153, which prohibits providing loans to directors and their relatives, also applies to LLCs.

Offshore

Offshore companies must similarly act in accordance with their articles, though notably they need not comply with the CCL 2015, except to the extent that they also operate onshore within the UAE.

2.4 Are any governmental or other consents or filings, or other formalities (such as shareholder approval), required?

In general, no governmental consents or filings are required in order to give effect to a guarantee in the UAE. However, a guarantee should be properly authorised by the company's constitutional documents and authorisations as previously stated. For onshore companies, a guarantee's form and substance should satisfy the requirements of the Civil Transactions Law (Federal Law No. 5 of 1985, as amended) (the "Civil Transactions Law") and the Commercial Transactions Law (Federal Law No. 18 of 1993) (the "Commercial Transactions Law"), as applicable. Practitioners should also consider that offshore companies may have their own legislation that governs such form and substance.

Additionally, if a transaction needs to comply with *Shari'a* principles, the pre-approval of *Shari'a* scholars is required as more fully described in the response to question 2.1.

2.5 Are net worth, solvency or similar limitations imposed on the amount of a guarantee?

As mentioned above, depending on the *Shari'a* structuring of the transaction, certain guarantees that assure a specified return for the lender may be restricted, and specific advice should be sought in this regard.

Onshore

For onshore companies, the Civil Transactions Law (Article 1061) requires that guarantees must be issued with respect to a specified debt or certain amount. In addition, the guarantee should be within the capacity of the guarantor to discharge. Therefore, whilst there is not a limit *per se*, a guarantor should not guarantee more than it can afford to repay. Guarantees should also be specific in nature, and whilst judgments have been made in the UAE that have recognised 'all-monies' guarantees, the above restrictions should be carefully considered on a case-by-case basis.

Offshore

There are no such limitations placed on DIFC or ADGM companies, other than those outlined in the response to question 2.2.

2.6 Are there any exchange control or similar obstacles to enforcement of a guarantee?

There are no exchange controls in the UAE that would restrict the enforcement of both onshore and offshore guarantees, aside from certain restrictions arising under international sanctions or local boycott regulations.

Onshore

The interpretation of the limitation period for onshore companies may affect enforcement of guarantees. Article 1092 of the Civil Transactions Law states that in relation to a surety, a creditor should claim the debt within six months of the date on which payment fell due. The Supreme Court in Abu Dhabi has stated that Article 1092 shall only apply to guarantees with respect to civil transactions and has found that the six-month time bar does not apply to guarantees in commercial transactions, particularly where the beneficiaries are financial institutions. In commercial transactions, if there is no time limit specified in the bank guarantee, the general limitation period under UAE law of 10 years shall apply as provided as UAE Law does not provide a specific limitation period specifically for bank guarantees. It is therefore common practice to disapply the provision that states the limitation period is six months in the relevant transactional documents, though it is not clear if this would succeed in ensuring that the provision would not have effect.

Offshore

Certain free zones have passed specific regulations which apply *in lieu* of the UAE Code of Civil Procedures (Federal Law No. 11 of 1992, as amended) (the "Code of Civil Procedures") and the Commercial Transactions Law. For example, the Law of Damages and Remedies DIFC Law No 7 of 2005 in the DIFC states that, excluding fraud, a claim cannot be commenced more than six years after the date of the event(s) that gave rise to the claim. However, should the free zones' legislation be silent regarding limitation periods, the period will be the same as under UAE law. The ADGM incorporates a number of English law statutes, including the Limitation Act 1980, by virtue of the English Law Regulations 2015. Under the Limitation Act 1980, a claim that is founded on a simple contract cannot be commenced more than six years after the date of the event(s) that gave rise to the claim. Where the claim is founded on a deed, a claim cannot be commenced more than 12 years from the date of the event(s) that gave rise to the claim.

3 Collateral Security

3.1 What types of collateral are available to secure lending obligations?

Although there are differences between the types of collateral available to onshore and offshore companies, both allow (with certain restrictions and limitations) security over: (i) real estate/land; (ii) tangible moveable property (e.g., machinery or stock); (iii) shares; (iv) receivables; and (v) cash deposits.

As outlined above, the Pledge Law governs the process of taking security over a wide variety of moveable property located onshore in the UAE, both tangible and intangible. The law has alleviated the more cumbersome aspects of taking security over moveable property, which was generally previously governed by the Civil Transactions Law and the Commercial Transactions Law. Some assets, such as shares, do not fall within the parameters of the Pledge Law.

For each free zone, the Federal or Emirate decree that created the free zone should be reviewed, as it may grant authority for that free zone to regulate matters relating to the taking of and enforcing of security. Most free zones will only have the power to regulate and promulgate laws regarding the incorporation of companies, and therefore the relevant Federal laws of the UAE and specific Emirate will continue to apply to all aspects not expressly regulated by the free zone. In relation to the DIFC, the creation, perfection and enforcement of security is governed by the DIFC Law No. 8 of 2005 ("DIFC Law of Security") and the DIFC Security Regulations, and the new DIFC Real Property Law (DIFC Law No. 10 of 2018). Such regulations more closely mimic common law-based regulations governing the taking of security.

In relation to the ADGM, the law relating to security is broadly governed by the ADGM Real Property Regulations 2015 ("ADGM Property Regulations"), the ADGM Company Regulations and the ADGM Insolvency Regulations 2015 ("ADGM Insolvency Regulations"). The legislation in the ADGM is also closely aligned with English law, with the most common form of security being taken over collateral being a charge. The law also recognises the distinction between the concept of fixed and floating charges which is a distinction that also exists under English law. A fixed charge would commonly be granted over land, machinery and shares whereas a floating charge usually covers all other current and future assets, including stock-in-trade. Debtors with a fixed charge have very limited ability to dispose of their assets whereas debtors with a floating charge are free to dispose of their assets in the ordinary course of business.

Foreign lenders should also bear in mind that ownership of land may be restricted to UAE (or GCC) nationals in certain Emirates. This has also been confirmed by the FDI Law, as land features as one of the sectors on the aforementioned negative list. Dubai, however, is generally more progressive in this regard as it permits foreign ownership of land in certain designated areas (Regulation No. 3 of 2006 Determining Areas for Ownership by Non-UAE Nationals of Real Property in the Emirate of Dubai). Such restrictions could affect the perceived value placed on any such security by lenders; the ability of a foreign lender to enforce its security package over, for example, real estate in an area that is not designated as freehold or over shares in a company incorporated onshore up to a percentage that exceeds the maximum that foreigners are entitled to own, should be borne in mind when negotiating the security package for any given transaction. This often triggers the need to consider a structured solution, or the involvement of a security agent or trustee.

3.2 Is it possible to give asset security by means of a general security agreement or is an agreement required in relation to each type of asset? Briefly, what is the procedure?

Whilst general overarching security agreements can be provided in the UAE, the general practice and advisable approach is to have separate agreements wherever possible. Further, as certain security documents may have to be notarised and registered with different government entities, particularly in relation to land and shares, it may create uncertainty and result in additional costs if they were to be included in the same agreement.

Additionally, in *Shari'a*-compliant transactions, *Shari'a* scholars will insist on the separation of subject matters in documentation to ensure that there is a reduced chance of material ambiguity (*Gharar*) in the agreements.

The procedures for the relevant security agreements vary from asset to asset (see the responses to questions 3.3 and 3.8).

3.3 Can collateral security be taken over real property (land), plant, machinery and equipment? Briefly, what is the procedure?

Onshore

A person or company owning property in the UAE (with the legal capacity to sell) can create a mortgage in favour of a mortgagee licensed by the UAE Central Bank. The mortgage can be over: (i) land and buildings; (ii) a leasehold interest; and/or (iii) a building erected on leased land.

In order to perfect a valid mortgage in the UAE, the land mortgage agreement (generally pre-printed documents prescribed by the relevant authorities) must be: (i) executed in writing in the presence of a public notary or the relevant land department in Arabic; and (ii) provided to the mortgage registrar with the land department or the local municipality of the relevant Emirate. A fee, which is usually payable, is dependent on the specific Emirate; however, it can commonly be linked to a percentage of the mortgage amount (see the response to question 3.9). This can be onerous on the borrower if they are covering the costs of the transaction. Furthermore, enforcement of such security can incur additional fees and expenses which may be prohibitive to the lending entity when it comes to an enforcement scenario and transferring title.

As discussed in the response to question 3.1, foreign lenders should also bear in mind that ownership of land, onshore companies and other assets may be restricted to UAE (or GCC) nationals in certain Emirates and, as such, the involvement of a local bank or a local/regulated security agent or trustee may be necessary. Furthermore, regardless of foreign ownership restrictions, certain types of security can only be given in favour of a bank licensed by the UAE Central Bank.

Lenders should also be aware that it is possible to take mortgages over ships and aircraft under the laws of registration of the relevant assets. In the case of mortgages over aircraft, the mortgage instrument may be filed with the General Civil Aviation Authority and a UAE pledge will also typically be taken over these assets. It is also worth noting that, in 2008, the UAE ratified the Convention and Aircraft Protocol on International Interests in Mobile Equipment on Matters Specific to Aircraft Equipment, commonly known as the Cape Town Convention.

Offshore

Interests in land in free zones may be subject to the regulations of such free zone. Property within the DIFC is governed by the DIFC Real Property Law, which outlines that land transactions must be registered in a central register administered by the DIFC and should include: (i) a description to identify the property; (ii) a description to identify the interest to be mortgaged; and (iii) a description of the secured debt or liability. The ADGM Property Regulations govern property within the ADGM and also provide that the Registrar shall maintain a real property register which shall record all documents relating to the creation or transfer of property rights in ADGM.

As with land, security over machinery and equipment in free zones may be subject to the respective free zone regulations, and the relevant Federal or Emirate decree which created the free zone should always be consulted. The DIFC and the ADGM, unlike UAE law, generally allow for the registration and enforcement of a floating charge (see the response to question 3.7 below).

3.4 Can collateral security be taken over receivables? Briefly, what is the procedure? Are debtors required to be notified of the security?

Yes, typically security over receivables is taken by an assignment of the contractual rights under the agreement giving rise to the receivables.

Onshore

The Pledge Law applies to the creation of security over receivables from third parties. The law provides that security may be created over receivables so long as the parties enter into a written agreement that complies with the requirements of the Executive Regulations (a "Pledge Contract"). In accordance with Article 4 of Executive Regulations, a Pledge Contract must contain a description of the property being pledged, which includes:

(i) a description of the pledged property, indicating quantity, piece, type, category or item, in a manner that indicates the essence of the pledged property;

(ii) a phrase indicating the creation of the right of pledge over the entire current or future moveable property;

(iii) a phrase indicating the creation of the right of pledge over the entire moveable property; and

(iv) a phrase indicating the creation of the right of pledge on a certain category or type of moveable property, whether current or future property, such as the phrase "all equipment" or "all the current or future receivables".

The process of online registration under the Pledge Law requires the following details:

(i) general information on the notice and security type (e.g. security right, finance lease, operating lease or consignment);

(ii) details of the party granting the security;

(iii) details of the creditor that will be receiving the benefit of the security;

(iv) details of other interested parties;

(v) a description of the moveable collateral that will be pledged as referred to above (there is no requirement to disclose the loan documents or proprietary information); and

(vi) statistical information (e.g. currency of the obligation, value of the obligations, type of collateral and related sector).

It should be noted that statistical information will not be made public on the Security Register, but should benefit the UAE by being a source of statistical data, which could assist with policy decisions. The registration process for initial security interests comes with a nominal fee of AED 100.

In addition to registration, it will also be necessary to notify any possessor of the secured property of the security interest being created if the relevant property is not in the possession of the security provider.

Offshore

Rules for assignments vary depending on the free zone. Security over receivables in the DIFC is governed and permitted by the DIFC Law of Security and the DIFC Security Regulations. Notably, the DIFC does not provide different rules depending on the asset to be secured (excluding land); hence all security to be taken in the DIFC must 'attach' to be effective. For 'attachment' to occur:

(i) a value must be given;

(ii) the debtor must have rights in the collateral or the power to transfer its rights in the collateral to a security party; and

(iii) one of the following: (a) the obligor must be bound by a security agreement that provides a description of the collateral; or (b) the collateral must be a negotiable document of title, a negotiable instrument, money, deposit account or financial property and the secured party must have control pursuant to the obligor's security agreement.

Perfection of the relevant security is attained once: (i) it is 'attached'; and (ii) a 'financing statement' is filed with the DIFC Security Registrar. The 'financing statement' should be filed within 20 days of the date of the security agreement and will lapse five years from the date it is filed (notwithstanding the term of the security agreement itself), pending a continuation statement.

However, it should be noted that a financing statement is not appropriate for security taken over the assignment of certain receivables (as set out in the DIFC Security Regulations) and monies held in an investment account (as defined in DIFC Personal Property Law (DIFC Law No. 9 of 2005)).

In relation to the ADGM, the ADGM Property Regulations permits for the assignment of choses in action, which includes receivables. However, it is necessary that the debtor be notified before such assignment.

3.5 Can collateral security be taken over cash deposited in bank accounts? Briefly, what is the procedure?

Onshore

The Pledge Law governs the taking of security over funds deposited in a UAE licensed bank. The law provides that the security shall be created by the parties entering into a written agreement which complies with the requirements of Executive Regulations. The Pledge Law provides that future property may be secured, which is particularly relevant in respect of security over cash deposits. The previous position was that the credit balance had to be fixed and identifiable, i.e. no floating charges were permissible, which in effect meant that the borrower had to maintain a blocked account. This resulted in some foreign lenders also requiring that additional security be taken over offshore accounts where floating security is recognised and enforceable. The Pledge Law is therefore a welcome development for banks when taking local law account pledges.

Non-resident foreign banks should also be aware that, under UAE law, a pledge over funds in a bank account can only be granted in favour of another bank or financial institution licensed in the UAE.

Offshore

Currently, the only free zones permitted to regulate banks are the DIFC and the ADGM. The relevant account charges are regulated by the DIFC Security Law and the ADGM Insolvency Regulations respectively. The procedure and restrictions (including monies held in an investment account) for the DIFC are set out in the response to question 3.4. For any other free zone, UAE law applies.

In the ADGM, companies are permitted to create charges in accordance with the ADGM Company Regulations. The charges must be registered with the Registrar of companies which must be provided with a statement of particulars which includes details such as the name of the company that is having their assets charged, the instrument creating the charge and the date of creation of the charge. The charge needs to be registered and failure to do so will result in the charge being void against creditors of the company. The instrument creating a charge is also required to be made available for inspection to any creditor or shareholder of the company at no cost and to any person upon payment of a fee which is to be prescribed by the company.

3.6 Can collateral security be taken over shares in companies incorporated in your jurisdiction? Are the shares in certificated form? Can such security validly be granted under a New York or English law governed document? Briefly, what is the procedure?

Security can be taken over shares in the form of a share pledge in relation to all onshore types of companies, including onshore LLCs and most offshore companies. The pledge documentation should always be governed by the relevant jurisdiction of the share register, which would typically be UAE onshore law or in the case of the DIFC or ADGM, DIFC law or ADGM law, as applicable.

Onshore

The procedure for pledging shares in a PJSC or PrJSC is by the physical delivery of the share certificates to the pledgee and entry of the pledge in the company register (though if the shares are not in certificated form physical delivery is not required). A PJSC will usually be required to be listed at one of the UAE's stock exchanges and the pledge should be recorded in the share register maintained by the relevant exchange. A PJSC will appoint a share register keeper (such as the Dubai Financial Market ("DFM") or Abu Dhabi Securities Exchange ("ADX")) to record the pledge. Upon such registration the pledgee typically has the right to collect dividends and entitlements attached to the shares, though in most cases these are returned to the borrower (with certain limitations) unless the borrower defaults.

Onshore LLCs did not previously have any clear legal guidance on how their shares could be pledged, and the pledge perfected. However, the CCL 2015 implements a new system (under Article 79) that allows pledges of shares in an LLC to be made in accordance with such company's articles, and under an official notarised document to be registered at the registrar of companies. In Dubai it is a requirement that pledges over shares must be registered with the Department of Economic Development to be effective.

As indicated, subject to the FDI Law, lenders should also bear in mind that foreign investors are still restricted in their ownership of capital regarding onshore companies (at least 51% should be owned by a UAE national) and therefore enforcement can be difficult. Typically, a local security agent or trustee will need to be engaged.

Offshore

Most offshore companies (including the DIFC and the ADGM) have physical share certificates that can be pledged and delivered, although this is not always the case. Most free zones also have their own registration requirements for such security, which may include execution of certain forms and filing of executed documents with the relevant free zone registrar.

3.7 Can security be taken over inventory? Briefly, what is the procedure?

Onshore

The Pledge Law governs the validity and enforceability of security over, *inter alia*, raw and primary products and commodities, equipment, machinery and work tools. The formalities of registration are as set in the response to question 3.3 above, and the security will have to be registered on the Security Register. As the law remains largely untested, we are yet to understand how the enforceability of such security shall operate in practice.

Prior to the introduction of the Pledge Law, the most common way to take security over machinery and trading stock was by way of a commercial mortgage. To register a commercial mortgage, it has to be executed in writing and the agreement has to be notarised and registered in the commercial register of the relevant Emirate's Department of Economic Development. Notice of the mortgage is to be given in two local Arabic newspapers two weeks prior to such registration. The registered mortgage will only be valid for a period of five years unless renewed and updated (notwithstanding the term in the underlying agreement). Whilst there has been widespread adoption and usage of the Pledge Law, its practical application is currently being tested and it is advisable that parties should take multiple forms of security to strengthen their position until the efficacy of the Pledge Law is ascertained.

Offshore

Security over such assets in free zones is subject to the relevant free zone requirements and applicable regulations. In the DIFC and ADGM, for example, it is possible to create a security interest over future assets/advances, acquired assets and the debtor's right to use, or dispose of all or part of the relevant items in line with the procedure set out in the response to question 3.4 above.

3.8 Can a company grant a security interest in order to secure its obligations (i) as a borrower under a credit facility, and (ii) as a guarantor of the obligations of other borrowers and/or guarantors of obligations under a credit facility (see below for questions relating to the giving of guarantees and financial assistance)?

Both onshore and offshore companies should be able to grant security to secure their own borrowings and those of other borrowers subject to the requirements and restrictions set out herein.

3.9 What are the notarisation, registration, stamp duty and other fees (whether related to property value or otherwise) in relation to security over different types of assets?

Stamp duty and taxes are not applicable for either onshore or offshore companies given the nil rate of direct tax applicable to most sectors in the UAE (see the response to question 6.1). Many financial services are also exempt from VAT, including the issuance, allotment or transfer of an equity or debt security. However, transfers of land may incur registration fees akin to stamp duty, payable to the relevant Emirates' land registry. These costs vary from Emirate to Emirate.

Notarisation is commonplace in the UAE, and even if not expressly required, may be used in order to add authority to documents. Fees in relation to this are normally charged at a very low percentage (approximately 0.25% and subject to a cap) of the secured amount, and importantly notarisation for onshore documentation is always in Arabic.

The Executive Regulations prescribe nominal fees for different services (which include the registration of pledged property and the modification of registration) for registration which range from AED 50 to AED 200. The exact fees are outlined in a schedule to the Executive Regulations.

Onshore

Onshore mortgage registration varies between Emirates; the Dubai Land Department, for example, currently charges 0.25% of the value of the mortgage amount. The fees for registration of other types of security vary depending on which Emirate the security is registered in but commonly involves a percentage of the amount secured and is subject to a cap.

Offshore

Registration varies in the DIFC; for example, a mortgage fee is USD 100 (or USD 273 for an Islamic mortgage), and if the property has not yet been registered with the DIFC Registrar of Real Property an additional fee (currently 5% of the total value of the property) is also payable. The cost of filing a 'financing statement' (see the response to question 3.4) is currently at a cost of USD 1 per USD 1,000 secured, subject to a minimum of USD 250 and a maximum of USD 5,000.

In relation to the ADGM, the application to register a mortgage is charged at USD 0.001 per AED 1000 of the value of the mortgage and is capped at USD 300,000.

3.10 Do the filing, notification or registration requirements in relation to security over different types of assets involve a significant amount of time or expense?

In comparison to the United Kingdom and United States, the process of securing assets is generally more complex and expensive. Arguably, the relevant free zones have a more straightforward approach, although it is still more uncertain than the established Western systems. This is somewhat due to a lack of formalised or standard structure of registrars for registration of each type of security in the relevant Emirates. The Security Register for the registration of security over moveable property alleviates some of this uncertainty; however, its practical use remains largely untested due to its infancy. The Security Register also allows searches to be made by details of the pledgor and 'Notice Registration Number'.

3.11 Are any regulatory or similar consents required with respect to the creation of security?

Typically, no regulatory or similar consents are required prior to the creation of a security. However, to the extent that a regulatory or government-owned body must accept registration of a certain security, this may be deemed a form of consent. Moreover, in circumstances where the secured assets are equities or other forms of securities, certain approvals may be required and structural considerations may need to be taken into account. Further, any security against government-owned assets or certain individuals within government organisations will require consent.

3.12 If the borrowings to be secured are under a revolving credit facility, are there any special priority or other concerns?

There are no specific concerns or case law relating to such matters that are apparent.

3.13 Are there particular documentary or execution requirements (notarisation, execution under power of attorney, counterparts, deeds)?

The procedures and requirement for security are set out in the answers to the questions above. For both onshore and offshore companies it should be noted that signing in counterparts is generally accepted practice; however for enforcement purposes, there should always be a 'counterparts' provision in the documentation.

For onshore entities executing specific security documents, including signing powers of attorney, in front of the relevant notary public and/or registrar may be necessary. Notably, the concept of a deed is not recognised in the UAE outside the DIFC and ADGM and therefore security documents will be entered into by simple contract. In addition, certain assets will require registration in a specified form as dictated by the relevant government or regulatory authority. Though counterparts are generally accepted, it is also advisable, based on judicial precedents, to encourage the signing parties to initial every page and clearly identify themselves and their authorities. In the case of corporate signatories, it is good practice that a company stamp should also be affixed. Offshore entities will typically follow the relevant execution requirements in their jurisdiction of incorporation.

4 Financial Assistance

4.1 Are there prohibitions or restrictions on the ability of a company to guarantee and/or give security to support borrowings incurred to finance or refinance the direct or indirect acquisition of: (a) shares of the company; (b) shares of any company which directly or indirectly owns shares in the company; or (c) shares in a sister subsidiary?

Onshore

There are currently no express provisions regarding the restrictions on a company's ability to guarantee or give security to support the acquisition of itself, its parent, or its subsidiary company.

However, the CCL 2015 states that a PJSC or PrJSC or any of its subsidiaries "*may not provide financial aid to any shareholder to enable the shareholder to hold any shares, bonds or Sukuk issued by the company*" (Article 222). The definition of such financial aid includes the granting of security over a company's assets or a guarantee for the obligations of another person to a third party. On 28 April 2016, the UAE Ministry of Economy issued guidance, by way of Ministerial Resolution No. 272 of 2016, confirming that the financial prohibition will not apply to LLCs.

Offshore

The relevant rules and regulations of the applicable free zone would need to be reviewed to understand their position in respect of financial assistance, but typically parties tend to err on the side of caution in such matters.

By way of example, within the DIFC, a public company or a subsidiary of such is prevented from providing financial assistance by granting security and providing guarantees by a company limited by shares in relation to the acquisition of shares in itself or in a holding private company unless: (i) such assistance would not materially prejudice the interests of the company and its shareholders or the company's ability to discharge its liabilities as they fall due and must be approved by the shareholders (90% in share value); (ii) finance or financial assistance is part of the company's ordinary business and is on ordinary commercial terms; or (iii) it is specified in DIFC Company Regulations (2018) as exempt. However, in relation to point (iii), should such financial assistance not fall under these exemptions, companies may consider using DIFC incorporated special purpose vehicles to provide financial assistance, if permitted by the DIFC Special Purpose Company Regulations.

In relation to the ADGM, Chapter 2 of the ADGM Company Regulations generally prevent a public company or a subsidiary of a public company (whether private or public) from providing financial assistance by granting security, a guarantee or an indemnity in relation to the acquisition of shares in such public company. The ADGM Company Regulations also prohibit a public company from giving financial assistance for the acquisition of shares in its private holding company. This distinction between public and private companies largely aligns with the English law Companies Act 2006.

5 Syndicated Lending/Agency/Trustee/Transfers

5.1 Will your jurisdiction recognise the role of an agent or trustee and allow the agent or trustee (rather than each lender acting separately) to enforce the loan documentation and collateral security and to apply the proceeds from the collateral to the claims of all the lenders?

The concept of 'trusts' and 'trustees' are more commonly referred to in the UAE as 'agent', 'security agent' or 'security trustee'. They are widely recognised concepts and often utilised in onshore, offshore (including the DIFC and ADGM) and Islamic finance structures. In Islamic transactions, if the deal is structured in compliance with *Shari'a*, the addition of an agent is not uncommon, in order for them to represent a group of lenders and protect their interests.

Further, as outlined in the response to question 3.6, onshore and offshore (including the DIFC and ADGM) entities in the region may require that a security agent be employed, particularly in the context of security which is granted in the region and can only be enforced by local institutions or entities that have specific licences. For example: (i) security over accounts – where a bank or financial institution should be the beneficiary of the security; and (ii) a lender who funds an organisation which has a teaching licence and is granted security by way of shares in itself – security can only be enforced over the shares if the lender itself has a teaching licence. Typically, this only becomes an issue upon enforcement; however, lenders should be mindful of this as it may affect the value they place on such types of security.

If a foreign lender is taking security over shares of an onshore entity which operates in a sector that is not permitted to be wholly owned by a foreign national, it may become difficult for that lender to enforce its security unless they are represented by a UAE national to ensure that they do not contravene any ownership restrictions. This is not an issue for offshore entities for which 100% foreign ownership is permitted.

5.2 If an agent or trustee is not recognised in your jurisdiction, is an alternative mechanism available to achieve the effect referred to above which would allow one party to enforce claims on behalf of all the lenders so that individual lenders do not need to enforce their security separately?

Agency is recognised, and in the DIFC and ADGM both agency and trustee roles are recognised, as more fully described in the response to question 5.1.

5.3 Assume a loan is made to a company organised under the laws of your jurisdiction and guaranteed by a guarantor organised under the laws of your jurisdiction. If such loan is transferred by Lender A to Lender B, are there any special requirements necessary to make the loan and guarantee enforceable by Lender B?

The UAE is a relatively new financial centre, and the practitioners based here are keen to emulate a system as advanced as those established in the United Kingdom and the United States. Thus, many of the practices and customs for financing transactions (especially for certain advanced offshore entities, including the DIFC and ADGM to a much larger degree) are similar to those utilised in the Western markets albeit occasionally with an additional tier of Islamic structuring. Hence, similar to Western markets, the mechanics for assignment or novation of the facility documentation, including the relevant guarantees, which are typically already provided for in the facility documents themselves, will be used.

6 Withholding, Stamp and Other Taxes; Notarial and Other Costs

6.1 Are there any requirements to deduct or withhold tax from (a) interest payable on loans made to domestic or foreign lenders, or (b) the proceeds of a claim under a guarantee or the proceeds of enforcing security?

Whilst the UAE has tax laws, the governmental authorities do not currently impose corporate taxes on companies other than on branch offices of foreign banks and certain energy companies (e.g. oil, gas and petrochemical). However, the VAT Law which levies 5% tax on certain commercial activities is based on the principles contained in the Unified GCC Agreement for VAT, published in the Kingdom of Saudi Arabia Official Gazette in April 2017. Other GCC nations such as the Kingdom of Saudi Arabia and the Kingdom of Bahrain have also introduced a VAT regime. The Sultanate of Oman plans to introduce its VAT laws in September 2019 and a Kuwaiti parliament committee suggested that State of Kuwait would postpone VAT implementation to 2021.

Companies with annual supplies in the UAE above AED 375,000 have to register for VAT. If a company has annual supplies above AED 187,500 it can voluntarily register. Similar to Western markets, if a company is engaged in the supply of goods or services that are subject to VAT (including at the zero rate), the company will be entitled to reclaim VAT that it incurs on its costs. Where the company is engaged in activities that are exempt from VAT and it cannot reclaim VAT incurred on costs, VAT will be a cost to its business (as suppliers will charge VAT that cannot be reclaimed). Reports from consultancy firms indicate that the introduction of VAT in the UAE and the Kingdom of Saudi Arabia has had a negative short term impact on the relative economies of each nation, as inflation has increased.

No withholding tax is currently payable in relation to principal payments, interest payments and other fees associated with the granting of loans. Currently, customs duties are typically very low, and personal income tax is not applicable; however, there are municipality service charges on individuals in the UAE by way of hotel and service (food) charges.

Various fees are payable for transferring property or land from one name to another (akin to stamp duty), including registration and notarisation fees (see the response to question 3.9). Notably, no income tax regime is currently in place which makes the region an attractive market for both individuals and corporations.

6.2 What tax incentives or other incentives are provided preferentially to foreign lenders? What taxes apply to foreign lenders with respect to their loans, mortgages or other security documents, either for the purposes of effectiveness or registration?

No preference is given to foreign lenders or financiers; however, the nil tax rate (subject to some exceptions as outlined in the response to question 6.1) is viewed as an incentive to invest in the region.

See the response to question 3.3 in respect of costs of registration. It should be noted that some free zones do not recognise the registration of security; hence the lenders have to rely on their contractual remedies in a default situation.

6.3 Will any income of a foreign lender become taxable in your jurisdiction solely because of a loan to or guarantee and/or grant of security from a company in your jurisdiction?

See the response to question 6.1.

6.4 Will there be any other significant costs which would be incurred by foreign lenders in the grant of such loan/guarantee/security, such as notarial fees, etc.?

Other than as outlined in the response to question 3.9, the costs to the lender are those that are imposed on them in their own jurisdiction of incorporation, if any.

Additionally, if a transaction is to be structured Islamically in accordance with the principles of *Shari'a*, this may also increase costs due to the document-heavy nature of such transactions and the need to involve *Shari'a* advisory boards.

6.5 Are there any adverse consequences for a company that is a borrower (such as under thin capitalisation principles) if some or all of the lenders are organised under the laws of a jurisdiction other than your own? Please disregard withholding tax concerns for purposes of this question.

No, there are not.

7 Judicial Enforcement

7.1 Will the courts in your jurisdiction recognise a governing law in a contract that is the law of another jurisdiction (a "foreign governing law")? Will courts in your jurisdiction enforce a contract that has a foreign governing law?

Onshore

Yes, both the Code of Civil Procedures and the Civil Transactions Law provide for the recognition of foreign governing law in contracts, provided that the conditions set out in the Code of Civil Procedures are satisfied. However, if a UAE Court accepts jurisdiction, especially in an enforcement scenario where assets are located in the UAE, it may ignore the choice of foreign governing law in a contract and apply UAE law insofar as enforcement relates to the domicile of the parties, and the location of assets in the UAE. There are some claims where the parties cannot contract out of the application of UAE law; for example real estate disputes where the real estate is onshore in the UAE.

Offshore

In the DIFC, Article 6 of the DIFC Judicial Authority Law (Dubai Law No. 12 of 2004 (as amended)) provides that the DIFC Courts may apply the laws of another jurisdiction where the parties to a dispute have explicitly agreed that such laws shall govern a dispute between the parties, provided that such law does not conflict with the public policy and morals of the UAE. In the ADGM, under Article 13 of Abu Dhabi Law No. 4 of 2013, the parties may agree to contract out of the ADGM Courts' jurisdiction and subject any dispute to the jurisdiction of any other court or arbitral tribunal.

7.2 Will the courts in your jurisdiction recognise and enforce a judgment given against a company in New York courts or English courts (a "foreign judgment") without re-examination of the merits of the case?

Onshore

The Code of Civil Procedures sets out in Article 235 the basis upon which UAE Courts will recognise and enforce foreign judgments or orders.

Article 235 provides that a foreign judgment may be recognised and enforced if:

(i) the law of the country in which the judgment was issued would recognise and enforce a UAE Court judgment. This usually means that the two countries have a bilateral treaty providing for recognition and enforcement of judgments. As neither the United States nor the United Kingdom have such treaties with the UAE, judgments would not be automatically enforceable without re-examination of the merits;

(ii) the UAE Courts have no grounds for jurisdiction to try the case in which the order or judgment was made;

(iii) the foreign court had jurisdiction in accordance with the rules governing international judicial jurisdiction within that country's own laws;

(iv) the parties to the action in which the foreign judgment was issued received proper notice;

(v) the judgment is final and not subject to appeal in the jurisdiction in which it was issued;

(vi) the judgment does not conflict with a judgment already made by a UAE Court; and

(vii) enforcement of the judgment does not conflict with the morals or public order of the UAE.

As a result, although a UAE Court may enforce a foreign judgment if it satisfies all of the conditions set out in Article 235, it is usually difficult for these requirements to be met. The fact that an applicant is seeking to enforce a judgment in the UAE implies that there is a nexus to the UAE in the factual circumstances underlying the case. On that basis, it is likely that a UAE Court may assert jurisdiction and reopen the merits of the case. A common pitfall for potential enforcement is to prove that the UAE Courts did not have jurisdiction to try the case, and even if all the other conditions set out in Article 235 are satisfied the UAE Courts may refuse to enforce the foreign judgment on these grounds.

The UAE is signatory to many bilateral treaties and international conventions for the mutual recognition of judicial and arbitral awards.

Offshore

The DIFC Courts Law (DIFC Law No. 10 of 2004 (as amended)) provides the DIFC Courts with discretion to ratify judgments of foreign courts. The DIFC Courts Law also requires that the DIFC Courts abide by any mutual enforcement or judicial cooperation treaties entered into between the UAE and other countries. The DIFC Courts have entered into a Memorandum of Guidance with each of the United States District Court for the Southern District of New York, and the Commercial Court, Queen's Bench Division, England and Wales, Australia and Singapore (amongst others). These memoranda address only money judgments, are not legally binding, and set out guidelines to be followed by the respective jurisdictions when assessing whether to enforce the judgments of the courts of the other jurisdiction.

However, a decision in the DIFC could impact the manner in which foreign judgments are enforced onshore going forward. The DIFC Court of Appeal in the case of *DNB Bank ASA v Gulf Eyadah* [CA-007-2015] (25 February 2016) held that a foreign judgment which has been granted recognition in the DIFC Courts becomes a judgment of the DIFC Courts and therefore should be treated as such by the Dubai Courts (onshore courts). This case involved the recognition of an English Commercial Court judgment in the DIFC Courts using the Memorandum of Guidance between the English Commercial Court, Queen's Bench Division, England and Wales and the DIFC Courts. There is also a system for enforcement between the DIFC Courts and the Dubai Courts (onshore) without review of the merits of the claim. This decision has therefore made apparent the potential for the DIFC Courts to be used as a "conduit" for an enforcement action in the Dubai Courts (onshore) against assets which are also onshore even where the parties have no connection with the DIFC. A subsequent DIFC Courts case of *Barclays Bank & Others v Essar Global Fund Limited* confirmed that where a claimant has received a foreign court judgment, it can be enforced against a Dubai-based party. This is done by virtue of the DIFC Courts acting as a conduit jurisdiction.

A further development has been the creation of the Judicial Committee under Dubai Decree No. 19 of 2016 forming the Judicial Committee of the Dubai Court and the DIFC Courts. The Decree came into immediate effect on 9 June 2016. The Judicial Committee has been created to resolve conflicts of jurisdiction between the DIFC Courts and Dubai Courts (onshore). The Judicial Committee determines any jurisdictional disputes between the Courts and also conflicting judgments of the DIFC and Dubai Courts (onshore) involving the same parties on the same subject matter, putting the legitimacy of the above-mentioned Dubai Courts conduit route into question. The Judicial Committee can also suggest rules and regulations to avoid jurisdictional conflicts arising. The Head of the Judicial Committee is the Chief Justice of the Court of Cassation in the Dubai Courts (onshore) and the other six members of the Judicial Committee are made of judges from both the DIFC Courts and Dubai Courts (onshore). Where there is a conflict between the DIFC Courts and the Dubai Courts (onshore), either a party to the dispute or the public prosecutor can make a request for the Judicial Committee to decide which court should hear the case or, if there are conflicting judgments, rule on which judgment should be enforced. Once a case has been referred to the Judicial Committee both courts must stay proceedings and the Judicial Committee's decisions will be binding and cannot be appealed.

Significant developments have also been made in the ADGM. On 11 February 2018, the ADGM Courts and the Abu Dhabi Judicial Department signed a memorandum of understanding ("MOU"), pursuant to Article 13 of Abu Dhabi Law No. 4 of 2013, permitting the reciprocal recognition and enforcement of judgments, decisions and ratified arbitral awards between the ADGM Courts and the Abu Dhabi Courts. Arbitral awards shall be given the same force as a binding judgment of either of the courts without the need for any further ratification by the other court. This mutual recognition and enforcement also extends to approved settlement agreements which have been certified by either court.

The intention is that, as a result of the MOU, judgments from the ADGM Courts will be enforceable in Abu Dhabi without the need for re-examination of the merits of the dispute.

The ADGM Courts, Civil Evidence, Judgments, Enforcement and Judicial Appointments Regulations 2015 permit the ADGM Courts to recognise the enforcement of foreign judgments and arbitral awards provided that the UAE has entered into an applicable treaty with the relevant country. In the absence of such a treaty, the Chief Justice of the ADGM Courts must be satisfied that the relevant foreign court has agreed to provide reciprocal recognition and enforcement for ADGM judgments.

7.3 Assuming a company is in payment default under a loan agreement or a guarantee agreement and has no legal defence to payment, approximately how long would it take for a foreign lender to (a) assuming the answer to question 7.1 is yes, file a suit against the company in a court in your jurisdiction, obtain a judgment, and enforce the judgment against the assets of the company, and (b) assuming the answer to question 7.2 is yes, enforce a foreign judgment in a court in your jurisdiction against the assets of the company?

Onshore

(i) Commencing an action for default is a relatively straightforward process. However, seeking a money judgment in the lower courts and enforcing such a judgment upon assets is usually a lengthy process that requires trying a case on the merits, and defending appeals if any are filed by an interested party. This process may in some instances, and depending upon the form of security and nature of the assets, take up to 24 months or even longer, even if there are no legitimate legal defences to non-payment.

(ii) The enforcement of a non-appealable judgment requires the filing of a separate "execution" case. Execution cases are subject to appeal. If the specific assets of the debtor in the UAE are undetermined, a series of inquiries with various UAE government authorities such as the land registries of the respective Emirate(s), the UAE Central Bank, the Securities and Commodities Authority, and the financial markets (the DFM and the ADX) must be made through the courts to identify assets. Real estate, securities, and (subject to the provisions of the Pledge Law) certain moveable assets such as vehicles and machinery will be subject to a public auction process.

Offshore

The enforcement of a security interest over assets located in the DIFC does not require a court order. The DIFC Law of Security governs the creation and enforcement of security over collateral located in the DIFC. The secured party must first notify the defaulting party to make payment or otherwise discharge its obligation to the secured party. The secured party must also notify any other priority creditors of which it is aware. If there is no objection by a priority secured creditor, the secured party may take steps to enforce its security interest over assets located within the DIFC. If the collateral is real property located within the DIFC, the secured party may record with the DIFC Security Registrar a written statement that a default has occurred and that the secured party is entitled to enforce the security interest.

The enforcement of security over a company's assets in the ADGM requires either the permission of the ADGM Court or consent from the administrator of the company in question.

7.4 With respect to enforcing collateral security, are there any significant restrictions which may impact the timing and value of enforcement, such as (a) a requirement for a public auction or (b) regulatory consents?

Yes.

(i) Whilst enforcement of security previously required a court order, the Pledge Law also introduces the concept of self-help remedies in relation to certain types of security (for example, secured bank accounts and bonds or endorsable instruments). Articles 28 to 33 of the Pledge Law provide additional mechanisms that allow the secured party to enforce its security without recourse to a public auction through the courts. The court does, however, have the right to choose the method of sale or to stipulate a minimum limit to the sale price. Certain collateral that does not fall within the parameters of the Pledge Law, such as real estate and shares, must still be liquidated through a public auction procedure in accordance with the Code of Civil Procedures.

(ii) The attachment and liquidation of publicly listed securities must be conducted in accordance with the procedures prescribed by the UAE Securities and Commodities Authority.

In relation to the enforcement of collateral security in the DIFC and ADGM, see the response to question 7.3.

7.5 Do restrictions apply to foreign lenders in the event of (a) filing suit against a company in your jurisdiction, or (b) foreclosure on collateral security?

There are no foreign lender-specific restrictions relating to filing suit against a company in the UAE or initiating security enforcement proceedings in the UAE.

7.6 Do the bankruptcy, reorganisation or similar laws in your jurisdiction provide for any kind of moratorium on enforcement of lender claims? If so, does the moratorium apply to the enforcement of collateral security?

Onshore

On 29 December 2016, the long-awaited Bankruptcy Law came into effect. The law introduces a protective composition process (where the debtor is in financial difficulty but not insolvent) and a restructuring scheme (as part of bankruptcy procedure), both of which are court-driven processes. Once the court has agreed to initiate proceedings for either the protective composition or the restructuring scheme, a moratorium applies to prevent claims against the creditors. Secured creditors will thereafter have to obtain the court's permission to commence enforcement proceedings.

Offshore

It is possible for a company in the DIFC and ADGM to be subject to: (i) administration; (ii) receivership; (iii) member's voluntary liquidation; (iv) creditors voluntary liquidation; and (v) compulsory liquidation.

The DIFC Law No. 3 of 2009 ("DIFC Insolvency Law") governs insolvency proceedings in the DIFC. The DIFC Insolvency Law allows the DIFC Courts to grant a moratorium, including in relation to the enforcement of collateral, to an eligible applicant (see question 1.1).

The ADGM Insolvency Regulations provide that a company in administration will have the benefit of a moratorium, whereby security cannot be enforced over the company's property except with the consent of the administrator of the company or with the permission of the ADGM Court.

7.7 Will the courts in your jurisdiction recognise and enforce an arbitral award given against the company without re-examination of the merits?

Onshore

Article 236 of the Civil Transactions Law stipulates that the same conditions set out in Article 235 for the enforcement of foreign judgments are applicable to foreign arbitral awards, which are set out in the response to question 7.2. The UAE is also a signatory to the Convention on the Recognition and Enforcement of Foreign Arbitral awards (New York, 1958), as well as other bilateral treaties and Conventions dealing with the mutual recognition of arbitral awards.

Offshore

In the DIFC, an arbitral award, irrespective of the jurisdiction in which it was made, is recognised as binding within the DIFC and upon application to the DIFC Court, is enforceable. A party may challenge enforcement under certain circumstances including when: a party to an arbitration was under some type of incapacity; the underlying arbitration agreement is invalid under the laws which the parties have subjected it to; the party against whom an award was granted was not provided with proper notice; the dispute in relation to which the award was granted falls outside the scope of issues contemplated by the parties to be submitted to arbitration; the composition of the arbitral tribunal or the arbitration procedures was inconsistent with the agreement of the parties or laws of the jurisdiction in which the arbitration took place; the award is not yet binding or has been suspended by a court of the jurisdiction in which it was made; the subject matter of the underlying dispute would not have been capable of settlement by arbitration under the laws of the DIFC; or if enforcement would be contrary to public policy in the UAE.

Where the UAE has entered into a mutual enforcement of judgments treaty, the DIFC and ADGM Courts (as courts of Dubai and Abu Dhabi, respectively) will uphold the terms of the treaty.

8 Bankruptcy Proceedings

8.1 How does a bankruptcy proceeding in respect of a company affect the ability of a lender to enforce its rights as a secured party over the collateral security?

Onshore

Enforcement actions over secured assets prior to the initiation of the protective composition or restructuring scheme (or the issuance of a bankruptcy judgment) are permissible if: (i) the underlying debts are due; and (ii) the court approves such enforcement. However, once the court has approved the composition or the plan, the trustee becomes entrusted with the sale of assets in line with the restructuring plan. The Bankruptcy Law clarifies that sale proceedings must be used first to prepay the debts due to secured creditors. However, if a secured asset is essential to the continuance of the business, the court may provide that the secured assets be substituted with other assets, provided that it does not prejudice the rights or interests of the secured creditors.

Should the preventive composition or restructuring scheme prove unsuccessful and the debtor is declared bankrupt, all debts become due and the debtor's assets must be sold in order to repay the secured creditors. If the sale does not occur within one month from the date of the bankruptcy judgment, the secured creditor may request to approve the enforcement over the secured assets.

Offshore

The DIFC Insolvency Law and the ADGM Insolvency Regulations both allow for a moratorium, including in relation to the enforcement of collateral, to an eligible applicant.

Dubai World – Decree 57

The Special Tribunal related to Dubai World ("Tribunal") was established by Dubai Decree No. 57 of 2009 issued by His Highness Sheikh Mohammed Bin Rashid Al Maktoum, in his capacity as the Ruler of Dubai. The Tribunal was established to hear claims against Dubai World, a Dubai Government-owned holding company, and its subsidiaries. The Tribunal was established following Dubai World's November 2009 announcement of its intention to seek the rescheduling of its debt obligations. The Tribunal applies the DIFC Insolvency Laws and, as such, allows the granting of moratoria including in relation to the enforcement of collateral.

8.2 Are there any preference periods, clawback rights or other preferential creditors' rights (e.g., tax debts, employees' claims) with respect to the security?

Yes. Secured creditors will have priority to be paid from the proceeds of the liquidation of the subject assets. It should be noted that the Pledge Law provides that the date and time of recording the pledge in the Security Register will be effective as against all parties and seek to establish priority *vis-à-vis* competing creditors.

Following payment to the court for any fees or costs, including the fees of trustees and experts, secured creditors will be paid according to the amount of their security. Any unpaid end of service gratuity, wages and salaries of employees of the debtor will then be payable provided that their total amount does not exceed the wage or salary of three months.

In the DIFC, the Law of Security ranks conflicting perfected security interests according to priority in time of perfection. The Law of Security grants perfected security interest priority over a conflicting, unperfected security interest, and provides for priority of the first security interest to attach if conflicting security interests are unperfected. In the ADGM, the priority of the charge will generally be determined from the date of its last registration and the charge will rank behind any security registered before such date.

8.3 Are there any entities that are excluded from bankruptcy proceedings and, if so, what is the applicable legislation?

The Bankruptcy Law applies to all commercial companies (except to entities not governed by special provisions regulating bankruptcy or subject to the provisions of the Federal Law 8 of 2004 regarding financial free zones), traders/merchants and civil partnerships (set up in accordance with the Civil Transactions Law). Individuals remain outside the scope of the Bankruptcy Law.

The DIFC Insolvency Law applies to any company that falls under the jurisdiction of the DIFC and has been incorporated pursuant to the New DCL. The ADGM Insolvency Regulations applies to any company registered in the ADGM within the meaning of the ADGM Companies Regulations.

8.4 Are there any processes other than court proceedings that are available to a creditor to seize the assets of a company in an enforcement?

As mentioned in the response to question 7.4 above, the Pledge Law introduces the concept of self-help remedies in relation to certain types of security. The direct enforcement of moveable assets is generally permissible by private sale, subject to prior agreement, notification by relevant parties and no other security interest existing. A pledge over claims and receivables may be set off if the pledgee is a bank and by claim if the account is held at another bank. Bonds and certain written instruments may be directly enforced through delivery or endorsement if their value is equal to the right of pledge, while written papers (e.g. bills of lading) may be directly enforced by application to the summary judge for the issuance of an urgent order.

In order to initiate direct enforcement, the pledgee must notify all concerned parties. There is currently no time limit for such notice. The Pledge Law also grants authority to summary judges to issue orders for enforcement of a registered pledge.

In the DIFC, a secured party may take steps to enforce its security interest over assets located within the DIFC without a court order whereas in the ADGM, the regime under the Insolvency Regulations will generally require the party that seeks to enforce security to obtain a court order.

9 Jurisdiction and Waiver of Immunity

9.1 Is a party's submission to a foreign jurisdiction legally binding and enforceable under the laws of your jurisdiction?

Yes. However, if there are grounds for a UAE Court to seize jurisdiction, the UAE Courts are likely to do so. See the responses to questions 7.1 and 7.2 for more background on this topic.

9.2 Is a party's waiver of sovereign immunity legally binding and enforceable under the laws of your jurisdiction?

Article 41 of the UAE Constitution provides that every person shall have the right to submit complaints to the competent authorities including the judicial authorities. As such, no entities (government or otherwise) are immune from being sued in the UAE. However, there are specific procedures that may have to be followed to sue certain governmental entities. Insofar as the Federal and local governments of the UAE are concerned, the Code of Civil Procedures, Article 247 contains a prohibition on the seizure of "public property" belonging to the UAE Federal Government or the governments of any of the individual Emirates to satisfy a judgment debt.

Some Emirates may also require the written consent and approval of the respective Emirate's Ruler's court or legal department be obtained prior to the filing of a claim against an Emirate's Ruler, government, or government entity. For example, in the Emirate of Dubai, the Dubai Government Lawsuits Law (Dubai Law No. 3 of 1996, as amended) requires the prior approval of the Ruler of Dubai before filing a lawsuit against the Ruler or a Dubai Government entity. Article 3*bis* explicitly states that no debt or financial obligation against the Ruler or the Government may be collected by means of detainment, public auction sale or possession by any other legal procedures of the properties and assets of the Ruler or of the Government whether such debt or financial obligation has received a final and conclusive judgment or not. The requests for such approvals must be made to the Dubai Government's legal department.

10 Licensing

10.1 What are the licensing and other eligibility requirements in your jurisdiction for lenders to a company in your jurisdiction, if any? Are these licensing and eligibility requirements different for a "foreign" lender (i.e. a lender that is not located in your jurisdiction)? In connection with any such requirements, is a distinction made under the laws of your jurisdiction between a lender that is a bank *versus* a lender that is a non-bank? If there are such requirements in your jurisdiction, what are the consequences for a lender that has not satisfied such requirements but has nonetheless made a loan to a company in your jurisdiction? What are the licensing and other eligibility requirements in your jurisdiction for an agent under a syndicated facility for lenders to a company in your jurisdiction?

Onshore

Licensing requirements in the UAE:

The Central Bank and the Securities and Commodities Authority ("SCA", also known as "ESCA") regulates financial services in the UAE. Pursuant to Federal Law No. 10 of 1980 and Federal Law 14 of 2018 the UAE Central Bank regulates financial institutions, including those that wish to provide financing in or from the UAE.

Whilst there are no local licensing requirements for foreign lenders which lend to UAE companies, if such entity operates within the UAE, it must be appropriately licensed. UAE lenders including commercial banks, investment banks, investment companies, finance companies, Islamic banks, Islamic finance companies and real estate finance companies based in the UAE are regulated by the UAE Central Bank and require a licence. Each of the institutions listed above must be 51% owned by a UAE national if incorporated in the UAE (as the banking and finance sector features on the FDI Law's negative list); however, for finance companies, commercial banks and investment banks, the minimum UAE national shareholding is 60% (Article 76 of Federal Law 14 of 2018). Branches of foreign banks can also be licensed as commercial banks in the UAE.

In order for a company to obtain a licence from the UAE Central Bank, the requirements set out in Federal Law 14 of 2018 must be satisfied (see, for example, Articles 67 to 71). Specific requirements are not listed in the respective legislation, but the applicant should expect to be notified if additional documents are necessary for the licence to be issued.

UAE lenders who enter into financial arrangements with a borrower in the UAE without a licence may face imprisonment for up to three months and/or be fined up to AED 2,000. Additionally, the institution may be liable for civil and criminal claims.

Additionally, an agent for a syndicate of foreign lenders is also not required to be licensed unless it is operating from and based in the UAE. Please note the requirements in respect of local agents relating to security as addressed in sections 3 and 5.

Offshore

Licensing requirements in the DIFC:

The principal regulator for regulating financial services within the DIFC is the Dubai Financial Services Authority ("DFSA"). An individual or entity based in the DIFC which provides a financial service must be authorised by the DFSA by obtaining the appropriate licence. If both the lender and the borrower are based in the DIFC, a Category 2 licence must be obtained, whereas if the lender is foreign, providing a credit facility to a borrower in the DIFC, licensing requirements do not exist.

The consequences of licensing violations can be severe. If a lender does not satisfy the requirements, DFSA, under the Regulatory Law and DFSA's Enforcement Rulebook can enforce the following actions as punishment: a fine of USD 100,000 per contravention; damages or restitution; injunctions and restraining orders; corporate penalties – unlimited fines through the Financial Markets Tribunal (the "FMT"); and a banning order through the FMT. As a consequence of violating the Financial Services Prohibition section of the Regulatory Law, lenders will also face censure by way of publication of any enforcement action leading to critical reputational damage and the loan agreement will be considered unenforceable.

Licensing requirements in the ADGM:

The principal regulator for regulating financial services within the ADGM is the Financial Services Regulatory Authority ("FSRA"). An individual or entity based in the ADGM which provides a financial service, which is classified as a regulated activity, must be authorised by the FSRA by obtaining the appropriate licence. The consequences of licensing violations in the ADGM can also be severe, with fines of up to USD 50,000.

11 Other Matters

11.1 Are there any other material considerations which should be taken into account by lenders when participating in financings in your jurisdiction?

The UAE financial services sector is still in its infancy when compared to more developed western financial markets, and whilst there is extreme wealth and numerous opportunities in the region, there is still a relatively high degree of uncertainty surrounding financing transactions in the region.

A challenging obstacle is the relative uncertainty of court decisions, given there is no concept of *stare decisis*. With the establishment of the DIFC courts, and more recently, the ADGM courts, which are based on common law, and not civil law systems, the judgments are, subject to certain conditions, enforceable onshore and therefore the UAE enforcement risk has somewhat been mitigated. However, even where such judgments are enforceable onshore, onshore assets are still subject to onshore rules regarding insolvency and taking of security. The promulgation of the Bankruptcy Law and the Pledge Law have certainly solved many of the issues lenders were facing upon enforcement over onshore assets but they still remain largely untested. Lenders providing financing into this market should carefully assess their enforcement risk over onshore assets and the risk of onshore insolvency proceedings. Lenders should also assess their *Shari'a* risk, in particular in *Shari'a*-compliant financings. Whilst English courts have typically taken a pragmatic view of *Shari'a*-compliant financings, looking through the *Shari'a* structure and into the substance of the financing arrangements (see *The Investment Dar Company KSCC v Blom Developments Bank SAL (Rev 1) [2009] EWHC 3545 (Ch) (11 December 2009)*), there is uncertainty as to how the UAE courts would rule in respect of claims by borrowers that their borrowings are not *Shari'a* compliant and therefore unenforceable. In this respect, Dana Gas' claims in 2017 that two of its Islamic bonds (which are now being restructured) totalling USD 700,000,000 were no longer compliant with *Shari'a* law and the subsequent injunction approved by a Sharjah Court to prevent investors from enforcing against Dana Gas stunned the markets. Lenders are therefore strongly advised to seek advice in relation to *Shari'a* compliance issues in the UAE.

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1 Overview

1.1 What are the main trends/significant developments in the lending markets in your jurisdiction?

The corporate lending markets in the United States are broad and deep relative to other jurisdictions. Market trends are often associated with certain segments of the lending markets, and market segmentation in the United States is based on a number of factors. These factors include: the size of the borrower (from so-called "large-cap" borrowers, to those in the "middle-market" to "small-cap"); the credit profile of the borrower (from investment-grade to below investment-grade or "leveraged"); the type of lender (banks, *versus* non-bank lenders, please see the discussion regarding "Direct Lenders" below); the number of holders of the debt (from syndicated loans, to "club" and bilateral facilities); whether the loan is secured, and the relative positions of the lenders *vis-à-vis* one another (from senior unsecured, to senior secured, mezzanine and second-lien loans); the basis on which the loan is made and repayment is (hopefully) assured (from a company's general credit rating, to cash flow loans, to asset-based loans); and the purpose of the loans (from acquisition finance and venture finance to general working capital loans, the development of specific projects and the purchase of specific assets). While there are trends within each of these market segments, there are also some broad trends which impact multiple segments. For example:

Rising Interest Rates (for now). The trend of rising interest rates that began in late 2015 continued through 2018 as economic conditions in the United States have continued to improve, prompting the Federal Reserve to further tighten US monetary policy in an effort to curb inflation. Before 2015, the Federal Reserve had kept interest rates at near-zero levels during and after the financial crisis in an effort to stimulate economic growth and curb unemployment by making it cheaper for companies to borrow. This low interest rate environment contributed to a borrower-friendly market: lower yields, higher leverage levels and weaker covenants and structures. Continued overall growth in the United States economy, including considerable improvement in the labour market since prerecession levels, led the Federal Reserve to raise short-term interest rates four times in 2018, closing the year with a December hike in the benchmark short-term rate from 2.25% to 2.50%.

Certain Trends in Loan Documentation. One of the most vibrant and innovative segments of the loan markets in the US is the fast-paced leveraged loan market. "What is market" on a variety of points, including leverage levels, spreads and covenants changes from month-to-month. Drivers of these changes include the demands of determined and resourceful borrowers and sponsors, the ebb and flow of the demand for leveraged loans, ambitions to command greater market share, due regard for credit risk and the other factors described below. Some broader trends in the market in recent years can be identified.

Convergence. The same investors often invest in leveraged loans and high-yield bonds. Leveraged loans typically have more restrictive covenants than high-yield bonds (although the gap has narrowed substantially) and are generally secured, so recoveries on leveraged loans after default are generally better. Investors judge the relative values of each of these instruments on a company-by-company basis. With each of these asset classes "competing" with the other, over the years many leveraged loans have taken on more bond-like characteristics, including incurrence-based covenants, no caps on dispositions, and greater flexibility for restricted payments.

Covenant-Lite Loans. When demand for leveraged loans is high (and borrowers have more leverage in negotiations) the trend is toward "looser" bond-like covenants, otherwise known as "covenant-lite". In covenant-lite loans, the borrower generally pays a premium in exchange for less restrictive covenants and no financial maintenance covenants (similar to high-yield bonds). While financial maintenance covenants test the borrower on a periodic basis, covenant-lite loan agreements typically only include "incurrence" covenants (which test the borrower upon a specific activity such as the incurrence of liens or debt, the making of acquisitions or restricted payments, etc.). Covenant-lite loans are viewed as having a greater risk of loss after default; with a covenant-lite loan, the first default is often a payment default, occurring long after a financial covenant default would have occurred. By that time, the borrower's financial condition is likely to have deteriorated substantially. Covenant-lite loans were popular before the financial crisis, dried up during the crisis and its aftermath, but have made a comeback in recent years and are now seen with greater frequency, including in middle market deals. In the third-quarter of 2018, according to Moody's Investors Service, the overall covenant quality of leveraged loans in the United States decreased to the weakest levels on record; in December, market conditions changed and covenants tightened, and in January and February of 2019, covenants trended back towards pre-December levels. In recent years, services have emerged that provide analysis and ratings of covenant packages so that the relative strength of covenant packages can be measured on a company-by-company basis.

The Power of Equity Sponsors. Equity sponsors drive much of the volume of leveraged loans and continue to exercise their market power and push the market towards more borrower-favourable terms. "SunGard" provisions continue to be standard in commitment papers. SunGard provisions allow equity sponsors who require acquisition financing to compete with strategic buyers who do not need such financing, by aligning closely the conditions in financing commitments to the conditions in the acquisition agreement. Equity sponsors increasingly require loan arrangers to use the sponsor's form of commitment letter so the sponsor can more easily compare the proposals of different financing sources. It has also become common for sponsors to prepare initial drafts of loan documentation. Another development unwelcome to many lenders is sponsors requesting the right to "designate" counsel for arrangers.

The Borrower's Desire for Flexibility: Unrestricted Subsidiaries, Equity Cures, Builder Baskets, Incremental Facilities and Reclassification. Equity sponsors and borrowers desire flexibility in their financing documents. This comes in many forms. The "unrestricted subsidiary" concept is consistent with features seen in bond indentures and this feature has become common in leveraged loan documentation. These provisions exclude specified subsidiaries from coverage in the representations, covenants and events of default, thus allowing a borrower to use an unrestricted subsidiary to incur indebtedness and liens or make investments without being subject to loan agreement restrictions. In effect, the lender loses the ability to monitor or restrict the unrestricted subsidiaries. A trade-off is that financial attributes of the unrestricted subsidiaries are excluded from the loan agreement provisions (including any benefit the borrower may have otherwise realised from cash flow generated by such subsidiaries for purposes of loan agreement financial ratios). "Equity cure" rights remain common. An equity cure allows a borrower's shareholders to make an additional equity investment in the borrower to cure breaches of its financial covenants. Loan agreements also continue to give borrowers more flexibility around so-called "builder baskets" (also known as "available amount" or "cumulative amount" baskets), which provide the borrower with more flexibility in complying with certain negative covenants. Builder baskets will often include an initial starter basket amount, which is in turn increased by either a borrower's retained excess cash flow or a percentage of a borrower's consolidated net income. Builder baskets may then be further increased in amount based on the occurrence of certain events, including certain equity contributions and declined proceeds from mandatory prepayments. Typically, borrowers are permitted to use builder baskets for capital expenditures, permitted investments and acquisitions, and often for equity distributions and repayment of subordinated debt (subject to leverage governors). Non-committed incremental facilities also remain common fare in loan agreements, permitting in an increasing number of cases (and now even in certain middle-market credit facilities) an uncapped amount of additional debt, so long as certain *pro forma* leverage ratios are satisfied. Borrowers are also requesting the ability to first utilise fixed dollar baskets in the context of certain negative covenants (for instance, debt, lien, investment and restricted payment negative covenants) and, if the borrower's financial condition later improves, to subsequently reclassify amounts incurred or paid under a fixed dollar basket such that these amounts are deemed incurred or paid under a leverage-based basket instead. The result of such a reclassification is that the borrower's fixed dollar basket for a negative covenant is then freed-up, so that the borrower can then incur or pay additional amounts under the fixed dollar basket, even if the borrower's financial performance should subsequently decline.

The Regulatory Environment. While the Federal Reserve had kept interest rates low to boost economic activity in the wake of the financial crisis, it and other federal regulators with a mandate to protect the US economy from excessive risk-taking associated with the financial crisis tightened regulations that arguably had the effect of increasing the cost of making loans. Under the current administration, however, federal regulators have begun to take steps to relax such regulations. For example, both the Chairman of the Federal Reserve Board and the head of the Office of the Comptroller of the Currency announced in February 2018 that the "Leveraged Lending Guidance" issued by federal regulators, which became effective in May 2013, is not legally binding on federally supervised financial institutions that are substantively engaged in leveraged lending activities. The guidance outlines high-level principles designed to assist institutions in establishing safe and sound leveraged finance activities. The guidance also had the effect of increasing lending costs as lenders re-evaluated their internal policies and programs and tightened their underwriting standards to comply. In light of this recent shift away from the Leveraged Lending Guidance, federally supervised financial institutions in 2018 showed a renewed willingness to make loans at leverage levels higher than the Leveraged Lending Guidance allows, a trend that may continue into the near future. Likewise, federal regulators in 2018 took initial steps towards easing federal "risk retention rules" and aspects of the "Volcker Rule", both of which impact CLO managers and banks that structure, warehouse and make markets in CLOs. The final Volcker Rule regulations were released on December 10, 2013, implementing the statutory Volcker Rule limits on trading operations, and private fund sponsorship and investment activities, of banking entities. In addition, banking entities engaged in permitted trading and permitted fund activities are required to create extensive compliance programs and meet new reporting requirements. The foregoing, combined with CLO capital requirements under Basel III, had a chilling effect on CLO issuances in the United States, with CLO issuance declining through 2016. This trend reversed in 2017 with a substantial increase in CLO issuances, which continued throughout 2018 (during which there was a record-setting amount of over $125 billion of CLO issuances). The willingness of federal regulators to reassess the Volcker Rule appeared in the context of new federal legislation that exempts smaller institutions from being subject to the Volcker Rule: the "Economic Growth, Regulatory Relief, and Consumer Protection Act", enacted in May 2018. These events reflect a broader goal of the current administration to ease various federal regulations that effectively curbed the participation by CLOs and traditional bank lenders in the United States loan markets from 2014 through 2016. While the final form and impact of these recent regulatory actions remain to be seen, US regulators did follow through on their message that they would be more lenient in 2018 with banks in connection with leveraged lending activities, a trend that seems likely to continue through 2019.

Sanctions and Anti-Corruption Laws. Federal regulators have in recent years increased their enforcement of sanctions, anti-terrorism and anti-corruption laws, meting out record fines. In addition to being more strident in their due diligence of borrowers, lenders are requiring stronger provisions in loan agreements to try and address these issues (and to demonstrate to regulators that they are doing the same). These provisions typically require the borrower and its affiliates to comply with sanctions regulations enacted by the US and other applicable authorities, to not use any borrowed proceeds in restricted countries or in doing business with restricted entities, and to comply with and have policies to comply with anti-bribery laws. Borrowers sometimes attempt to negotiate these provisions, including by adding materiality or knowledge qualifiers, with some limited success.

Federal Income Taxes. The Tax Cuts and Jobs Act of 2017 (the "2017 Act") enacted sweeping changes to the Internal Revenue Code of 1986, as amended (the "Code"), including numerous provisions that may impact the US federal income tax treatment of participants in the US lending markets. These changes may impact the tax treatment of credit support provided by non-US subsidiaries, as more fully described in question 2.6 below.

The Foreign Account Tax Compliance Act ("FATCA"), which became effective with respect to interest payments on July 1, 2014, was a major revamp of the US withholding tax regime. FATCA imposes a 30% gross withholding tax on certain amounts, including interest, paid by US borrowers to a foreign lender unless that lender (i) enters into an agreement with the IRS to identify and report specified information with respect to its US account holders and investors, or (ii) is resident in a jurisdiction that has entered into an intergovernmental agreement (an "IGA") with the United States pursuant to which the government of that jurisdiction agrees to report similar information to the United States. This sweeping law has significant impact on loan payments and receipts where it applies and has prompted loan parties to manage FATCA risk (express allocation of risk set forth in loan documentation, operation of gross-up clauses, etc.). In the US loan market, for example, loan agreements now almost universally contain provisions whereby any FATCA withholding is exempt from a borrower's gross-up obligation, and a borrower may request information from a lender to determine whether such lender is in compliance with FATCA. (It is worth noting that while current provisions of the Code and Treasury regulations that govern FATCA also treat payments of principal on, or the gross proceeds from a sale or other disposition of, debt obligations of US borrowers as subject to FATCA withholding beginning with dispositions on or after January 1, 2019, under recently proposed Treasury regulations, such principal payments and/or gross proceeds would not be subject to FATCA withholding; in the preamble to such proposed regulations, Treasury and the US Internal Revenue Service have stated that taxpayers may generally rely on the proposed Treasury regulation until final Treasury regulations are issued.)

Bankruptcy Reform. On January 8, 2018, Senator John Cornyn introduced and Senator Elizabeth Warren co-sponsored the Bankruptcy Venue Reform Act of 2018 (the "Venue Bill"), which would alter the existing criteria for determining proper venue for bankruptcy cases. The Venue Bill would remove the language that allows companies to file for bankruptcy protection where they are incorporated or where they operate much smaller affiliates. The Venue Bill has been referred to the Senate Committee on the Judiciary for review. Senator Cornyn noted that the bill is meant to "close the loophole that allows corporations to 'forum shop' for districts sympathetic to their interests" and according to Senator Warren, would prevent debtors from "cherry-picking courts that they think will rule in their favor". If passed, the Venue Bill would mark a significant shift in corporate bankruptcy practice.

Continued Innovations and Ongoing Trends in the Loan Markets. Given the depth and breadth in the loan markets in the US, many loan market innovations originate or are further developed here (consider, for example, the development of a sophisticated secondary trading market, certain mezzanine and second-lien structures, the securitisation of loans and CLOs). Some innovations include the following:

The Unitranche Facility. One innovation that continued to remain popular in 2018 (and which is now firmly established in middle-market lending in the United States and is also now much more prevalent in European markets) is the so-called "unitranche" facility. Unitranche loans combine what would otherwise be separate first/second-lien or senior/mezzanine facilities into a single debt instrument, where all the debt is subject to the same terms, and with a blended interest rate. Lenders in unitranche facilities typically enter into a so-called "agreement among lenders" ("AAL") which legislates payment priorities, voting rights, buy-out rights, enforcement rights and rights in bankruptcy among lenders in a manner that may not be visible to the borrower. One advantage of unitranche loans for a borrower is speed and certainty of closing (important in a competitive acquisition process), since negotiation of an intercreditor agreement typically is not a condition to funding. Another supposed advantage for the borrower is the simplicity of decision-making during the life of the loan since there is no "class voting" from the perspective of the borrower (though the AAL may impact voting issues in ways not visible to the borrower). The use of these facilities has so far been restricted to the middle-market, and lenders of unitranche loans typically are Direct Lenders (and not banks). In recent years, the United States loan markets have continued to see increased complexity in unitranche structures and in the terms of AALs. Borrowers and their equity sponsors have had some success in requiring disclosure of terms of AALs, especially with respect to voting, and in some instances the borrower now executes the AAL by signing an acknowledgment to the document. The United States Bankruptcy Court for the District of Delaware implicitly recognised the court's ability to construe and enforce the provisions of an AAL (to which the borrower was not a party) in March 2015 in the *In re RadioShack Corp.* bankruptcy, signalling to lenders that AALs should be enforceable in bankruptcy.

Bank Lenders Versus Direct Lenders. Non-bank lenders, often referred to as direct lenders or alternative lenders ("Direct Lenders"), are typically speciality finance companies, sometimes organised as business development companies ("BDCs") or funds, and also include the direct lending business of large asset managers. Unlike traditional banks, Direct Lenders have greater flexibility than banks to hold leveraged loans on their balance sheets, which provides borrowers with greater deal certainty, since Direct Lenders, unlike banks, may not need to condition deal terms based on their ability to syndicate a loan. Direct lenders also often invest at different levels of a borrower's capital structure, such as by making an equity investment at the same time as providing a credit facility, which provides added benefit to equity sponsors and borrowers seeking to raise capital. While traditional banks and Direct Lenders compete for market share, especially in the middle-market leveraged lending space, some market participants point out that the relationship is actually more symbiotic in nature; for example, banks provide debt financing to Direct Lenders and underwrite equity issuances by Direct Lenders and also have analysts that "follow" equity securities of BDCs. Some banks have developed Direct Lender businesses. The introduction of the Leveraged Lending Guidance mentioned above provided a competitive advantage to Direct Lenders. The Guidance helped to open the door for Alterative Lenders to become a "go to" source of capital for equity sponsors and borrowers in the leveraged-lending markets, especially for middle-market borrowers, given that such Direct Lenders were not subject to the same regulatory constraints. Whether the pull-back of the Leveraged Lending Guidance will shift the needle back in the direction of the traditional banks, will be interesting to watch.

Litigation Finance. While originally developed in Australia and the United Kingdom, the business of litigation finance has gained traction in the United States and is growing rapidly. A common type of litigation finance occurs when a third-party investor provides funds to a plaintiff (or plaintiff's attorney) in exchange for a contractual commitment to receive a share of the award or settlement (or contingency fee) resulting from litigation. Such financing is typically limited recourse, and the investor is only repaid if the plaintiff (or plaintiff's attorney) wins an award, though investors can realise significant returns, usually a multiple of their initial investment. Litigation finance has its share of critics, including those who characterise such finance as "turning the court system into a stock exchange". Other legal observers argue litigation finance helps to "level the playing field" when parties in litigation have unequal financial or bargaining positions. In recent years, established financial institutions and new investment firms have raised billions of dollars to invest in litigation finance and the US market will likely see an increase in this form of financing in the future.

1.2 What are some significant lending transactions that have taken place in your jurisdiction in recent years?

Given the large number of transactions in the US corporate loan markets, it is difficult to differentiate certain lending transactions as being more significant than others. Any such comparison necessarily excludes transactions for which documentation is not publicly available and therefore favours large corporate deals filed with the SEC compared to those in the middle-market, where much loan product innovation takes place. Nevertheless, some transactions that illustrate some of the concepts discussed above include: *Covenant-Lite*: Lifetime Brands, Inc. (March 2, 2018) and XPO Logistics, Inc. (December 24, 2018); *Equity Cures*: TriNet USA, Inc. (June 21, 2018) and Wingstop Inc. (January 30, 2018); *Builder Baskets*: Blue Bird Body Company (December 12, 2016) and Revlon Consumer Products Corporation (September 7, 2016); *Unrestricted Subsidiaries*: Del Frisco's Restaurant Group, Inc. (June 27, 2018) and Claire's Stores, Inc. (September 20, 2016); *Incremental Facilities*: Foundation Building Materials Holding Company LLC (August 13, 2018) and Dave & Buster's, Inc. (August 17, 2017); and *Reclassification:* AdvancePierre Foods, Inc. (June 2, 2016) and Ball Corporation (March 18, 2016).

2 Guarantees

2.1 Can a company guarantee borrowings of one or more other members of its corporate group (see below for questions relating to fraudulent transfer/financial assistance)?

Generally, yes. In the US, guarantees are commonly referred to as one of three types: (a) "downstream" guarantees, whereby a parent company guarantees the debt of a subsidiary; (b) "upstream" guarantees, whereby a subsidiary guarantees the debt of a parent; and (c) "cross-stream" guarantees, whereby a subsidiary guarantees the debt of a "sister company". Generally, "upstream" and "cross-stream" guarantees may be subject to increased scrutiny given enforceability issues in the context of a bankruptcy, as further described below.

2.2 Are there enforceability or other concerns (such as director liability) if only a disproportionately small (or no) benefit to the guaranteeing/securing company can be shown?

First, as a matter of contract law, some "consideration" (bargained-for contractual benefit to the guarantor) must be received for the guarantee to be enforceable, though this contract law threshold is typically easy to meet.

As a matter of insolvency law, certain types of enforceability issues arise in the context of a bankruptcy. These issues are analogous to, but not the same as, contractual concepts of "consideration". With downstream guarantees, there is typically little concern, since the parent will indirectly realise the benefit of a loan through the value of its equity ownership of the subsidiary (unless the subsidiary is already, or is rendered, insolvent). However, "upstream" and "cross-stream" guarantees should be subject to increased analysis since the benefit to the guarantor is less evident.

For example, a guarantee or other transaction may be voided by a bankruptcy court in the US if it is found to be a "fraudulent transfer". Very generally, under the federal Bankruptcy Code, a guarantee may be considered a fraudulent transfer if, at the time the guarantee is provided, (a) the guarantor is insolvent (or would be rendered insolvent by the guarantee), and (b) the guarantor receives "less than reasonably equivalent value" for the guarantee. (Note that both prongs of the test must occur in order for the guarantee to be voided as a fraudulent transfer; if the guarantor receives "less than reasonably equivalent value" though is nevertheless solvent at the time the guarantee is provided (after giving effect to the guarantee), then the guarantee should not be voided as a fraudulent transfer.) As mentioned above, in a downstream guarantee context, the parent would more likely receive "reasonably equivalent value", therefore fraudulent transfer is less of a concern for these types of guarantees. In addition to the federal Bankruptcy Code fraudulent transfer test, under state laws there exist similar fraudulent transfer statutes and a federal bankruptcy trustee may also use these tests to void the guarantee in a bankruptcy.

Loan documentation will often provide for solvency representations from borrowers and guarantors in order to address fraudulent transfer concerns. In some high-risk transactions (such as acquisition loans or loans provided so the borrower can make a distribution to shareholders), a third party is required to provide a solvency opinion in order to provide protection from fraudulent transfer attack, though the more common practice today is for lenders to do their own analysis given the expense of such outside opinions.

Under relevant corporate law, if a guarantee or similar transaction is structured in such a way that it would be tantamount to a distribution of equity by a company while the company is insolvent (or is rendered insolvent), or would impair the company's capital, the transaction may be improper under the corporate law and could result in director liability. See also question 2.3 below for a general discussion of corporate power issues.

2.3 Is lack of corporate power an issue?

Entity power to enter into a guarantee is generally governed by the corporation (or equivalent) law in the state in which the company is organised, as well as the company's charter and bylaws (or equivalent documentation).

For corporations, the corporation law of most states provides a broad range of permitted business activities, so few activities are considered to be *ultra vires* or beyond the power of a corporation (note that certain special purpose or regulated entities, such as banks, insurance companies, and utility companies, may be subject to additional statutes which impact corporate power). In a lending context, however, many state corporation statutes limit the power of subsidiaries to guarantee the indebtedness of a corporate parent or a sister company, and a guarantee may be *ultra vires* if not in furtherance of the guarantor's purposes, requiring analysis of the purpose of the guarantee and the benefit to the guarantor. If the benefit to the guarantor is intangible or not readily apparent, this may provide additional concern. Many corporate power statutes, however, provide safe harbours for certain types of guarantees, irrespective of corporate benefit, including if the guarantor and the borrower are part of the same wholly owned corporate family, or if the guarantee is approved by a specified shareholder vote, for the guarantor entity. For limited liability companies, state statutes are usually more generous, with a limited liability company generally able to engage in any type of legal activity, including entering into guarantees, unless the charter provides otherwise.

In lending transactions in the US, the analysis that a company has the corporate or other requisite power to enter into a guarantee is often provided in a legal opinion provided by the guarantor's internal or external counsel (though these opinions will typically assume away the tough factual issues, such as the level of corporate benefit).

2.4 Are any governmental or other consents or filings, or other formalities (such as shareholder approval), required?

In addition to having "corporate power" (or equivalent power for other types of entities) to enter into a guarantee, the guarantee must be properly authorised, which generally means that the procedural rules of the corporation, as set forth in its charter or by-laws, must be followed and that the stockholders or the governing board take the proper measures to authorise the transaction. These procedures are customary and also typically covered in a legal opinion provided by the guarantor's counsel.

One situation that requires special attention in a guarantee context is when a guarantor is providing an upstream or cross-stream guarantee, and the guarantor has minority shareholders. In this context, often the consent of the minority shareholders would be required in order for the guarantee to be provided in order to address fiduciary duty concerns.

Generally, no governmental consents, filings or other formalities are required in connection with guarantees (though, as noted above, certain special purpose companies and regulated entities may be subject to additional requirements).

2.5 Are net worth, solvency or similar limitations imposed on the amount of a guarantee?

Yes, please see question 2.2.

2.6 Are there any exchange control or similar obstacles to enforcement of a guarantee?

Generally, no. Though there are a few other issues worth mentioning that do not relate to "enforcement" *per se*. For example, there may be withholding tax issues if the payment is to a foreign lender (please see question 6.1).

In addition, there are important tax issues to consider when structuring a transaction with credit support from foreign subsidiaries of US companies, and the rules in this regard have recently been changed. For example, there may be adverse US federal income tax consequences for certain US borrowers resulting from the involvement of any non-US subsidiary guaranteeing or otherwise providing credit support for the debt of that US borrower. Under US tax rules, such a guarantee could be construed to result in an income inclusion, similar to a "deemed dividend", from the non-US subsidiary to the US parent in the full amount of the guaranteed debt, and this deemed dividend would generally be subject to US tax. The same result could apply, under US tax rules, if collateral at the non-US subsidiary is used to secure the loan to the US parent, or if the US parent pledges more than 66% of the voting stock of a first-tier non-US subsidiary.

Recently enacted changes to the Code pursuant to the 2017 Act impacted the scope of taxpayers affected by these aforementioned US tax rules (the "Guarantee Rules"). For example, the class of non-US subsidiaries potentially subject to these Guarantee Rules was broadened to include certain non-US subsidiaries of certain non-US parents. However, the enactment of a "participation exemption" with respect to dividends received by corporate US owners of wholly owned non-US subsidiaries, and the extension via proposed US Internal Revenue Service and Treasury regulations (the "Proposed Regulations") of this exemption to the income inclusions that are triggered by the application of these Guarantee Rules, may reduce or eliminate the impact of these Guarantee Rules for certain corporate US borrowers that own non-US subsidiaries. Moreover, given the Proposed Regulations, lenders may now be more inclined to require non-US subsidiaries to provide a guarantee and asset pledge as credit support in respect of loans to a US corporate parent borrower (and likewise require the US corporate parent borrower to pledge 100% of its equity interests in its non-US subsidiaries).

3 Collateral Security

3.1 What types of collateral are available to secure lending obligations?

A wide variety of assets (including land, buildings, equipment, inventory, accounts, contract rights, investment property, deposit accounts, commercial tort claims, etc.) are available for use as security for loan obligations with many of the most common types of collateral described more fully below. Assets used as security are often divided into two broad categories: (a) "personal property" which generally refers to property other than real property (land and buildings); and (b) real property.

The Uniform Commercial Code ("UCC") provides a well-developed and predictable framework for providing security interests in a wide variety of personal property assets. The UCC is a state law statute rather than a federal one, but the UCC has been adopted by all 50 states in the US and the District of Columbia, with only a few non-uniform amendments of significance.

Under the UCC, when a security interest "attaches", it becomes enforceable as a matter of contract by the lender against the borrower. "Attachment" typically occurs when credit is extended to the borrower, the borrower has ownership or other rights in the collateral in which to grant a security interest, and the borrower signs and delivers to the lender a written security agreement describing the collateral.

After attachment, the security interest must be "perfected" by the lender in order for the lender's security interest to have priority over the rights of an unsecured creditor who later uses judicial process to obtain lien on the collateral. Since a federal bankruptcy trustee has the same status as a state law judicial lien creditor under US law, a bankruptcy trustee will be able to set aside the security interest if the security interest is not perfected.

The method of perfecting a security interest under the UCC depends on the type of collateral in question. The most common method of perfecting a security interest is by "filing" a financing statement in the appropriate state filing office. The UCC provides specific rules for where to file a financing statement, with the general rule that the filing takes place in the jurisdiction where the borrower is located. A borrower organised under a state law in the United States as a corporation, limited partnership, limited liability company or statutory trust is considered to be located in the state in which it is organised. The filing contains only brief details including the name of the borrower, the name of the secured party and an indication of the collateral, and the filing fee is generally fairly nominal. Security interests in some collateral may be perfected by "possession" or "control" (including directly held securities, securities accounts and deposit accounts). A security interest in certain collateral may be perfected by more than one method.

If two or more lenders have perfected security interests in the same collateral, the UCC provides rules for which lender has "priority" over the other security interest. This is usually determined by a "first-in-time" of filing or perfection rule, but there is a special rule for acquisition finance ("purchase-money") priority and special priority rules also apply to certain collateral (e.g., promissory notes, investment securities and deposit accounts) if a security interest is perfected by possession or "control".

In addition, security interests in certain types of personal property collateral may to some extent be governed by federal statutes and pre-empt the UCC rules. For example, the perfection of a security interest in an aircraft is governed by the Federal Aviation Act and the perfection of a security interest in a ship above a certain tonnage is governed by the federal Ship Mortgage Act.

The requirements for taking a security interest in real property (referred to as a "mortgage" or "deed of trust" in the US) are determined by the laws of the state where the real property is located. Typically the office in which to file the mortgage or deed of trust is in the county of the state where the land is located. These statutes are fairly similar from state to state, but less consistent than the rules for personal property. As a result, mortgage documents from state to state appear quite different, while security agreements with respect to personal property (governed by the more consistent UCC of each state) are more uniform. Lenders often obtain a title insurance policy in order to confirm the perfection and priority of their security interest in real property.

A security interest in fixtures (personal property that permanently "affixes" to land) is generally perfected by filing in the place where the real property records are filed. A security interest in fixtures may be perfected under the UCC or under the local real estate law.

3.2 Is it possible to give asset security by means of a general security agreement or is an agreement required in relation to each type of asset? Briefly, what is the procedure?

In general, a single security agreement can cover all UCC personal property which is taken for security as a loan, no matter where the personal property is located.

With respect to real property, generally a separate mortgage or deed of trust document is used for each state where real property is located, given that the mortgage document is typically governed by the laws of that particular state.

3.3 Can collateral security be taken over real property (land), plant, machinery and equipment? Briefly, what is the procedure?

Yes. Please see question 3.1.

3.4 Can collateral security be taken over receivables? Briefly, what is the procedure? Are debtors required to be notified of the security?

Yes. Receivables are considered personal property, and a security interest in the receivables granted under a security agreement would typically be perfected by filing a financing statement in the appropriate filing office. If the receivable is evidenced by a promissory note or bond or by a lease of or loan and security interest in specific goods, the receivable may also be perfected by the lender's possession or "control". Debtors on the receivables are not required to be notified of the security interest in order for perfection to occur.

The security agreement can grant a security interest in future receivables. An already filed financing statement will be effective to perfect a security interest in a future receivable when it arises.

3.5 Can collateral security be taken over cash deposited in bank accounts? Briefly, what is the procedure?

Yes. A security interest granted under a security agreement in a deposit account as original collateral must be perfected by control (not by filing). To obtain control of the deposit account, a secured lender typically enters into a control agreement with the borrower and the institution that is the depositary bank by which the bank agrees to follow the lender's instructions as to the disposition of the funds in the deposit account without further consent of the borrower. Many depositary banks have forms of control agreements which they will provide as a starting point for negotiations. (However, if the secured lender is also the depositary bank or the lender becomes the depositary bank's customer on the deposit account, control is established without the need for a control agreement to perfect the security interest.)

3.6 Can collateral security be taken over shares in companies incorporated in your jurisdiction? Are the shares in certificated form? Can such security validly be granted under a New York or English law governed document? Briefly, what is the procedure?

Yes. Companies are typically incorporated under the laws of individual states in the US, and usually not under federal law. Shares may be issued in either certificated or uncertificated form.

A security interest may be created by either a New York law or English law-governed security agreement. If the security agreement is governed by English law, the UCC in New York requires that the transaction bear a reasonable relationship to England for the choice of law clause to be enforceable. (Please also see question 7.1 as to the extent a court in New York will enforce a contract that has a foreign governing law.)

In general, a security interest in such directly-held shares can be perfected either by filing or by control, though perfection by control has priority. The law governing perfection of such security interest in certificated securities depends on whether perfection is achieved by filing (location of debtor) or by control (location of collateral).

If the shares are credited to a securities account at a bank or broker and are therefore indirectly held, a borrower's interest in the securities account can be perfected either by filing or control. Once again, perfection by control has priority. The law governing perfection of a security interest in a securities account depends on whether perfection is achieved by filing (location of debtor) or by control (location of bank or broker as determined usually by the law governing the securities account relationship).

3.7 Can security be taken over inventory? Briefly, what is the procedure?

Yes. Please see question 3.1. A security interest may be granted under security agreement and may be perfected by the filing of a financing statement in the appropriate UCC filing office. Perfection may also be achieved by possession, though this method is seldom practical from a secured lender's perspective.

The security agreement can grant a security interest in future inventory. An already filed financing statement will be effective to perfect a security interest in a future inventory when it is created or acquired.

3.8 Can a company grant a security interest in order to secure its obligations (i) as a borrower under a credit facility, and (ii) as a guarantor of the obligations of other borrowers and/or guarantors of obligations under a credit facility (see below for questions relating to the giving of guarantees and financial assistance)?

Yes to both (i) and (ii). Note that with respect to item (ii), a guarantor would be subject to the same fraudulent transfer analysis discussed in question 2.2.

A security agreement may also secure obligations relating to future loans. An already filed financing statement perfecting a security interest securing existing loans will be effective to perfect a security interest in a future loan when the loan is made.

3.9 What are the notarisation, registration, stamp duty and other fees (whether related to property value or otherwise) in relation to security over different types of assets?

With respect to personal property governed by the UCC, and the filing of financing statements, there are typically no material costs and UCC filing fees are usually minimal.

With respect to real property, there may be significant recording taxes and fees. These taxes and fees will depend on the state and local laws involved. A number of practices are used in loan transactions in an attempt to minimise such costs. For example, in the case of refinancings, lenders may assign mortgages rather than entering into new mortgages; and in the case of mortgage tax recording states, lenders may limit the amount secured by the mortgage, so that the mortgage tax payable is set at a level commensurate with the value of the property as opposed to the overall principal amount of the loans.

3.10 Do the filing, notification or registration requirements in relation to security over different types of assets involve a significant amount of time or expense?

Please see question 3.9. In terms of a time-frame, UCC personal property security interests may be perfected in a matter of days. Real property security interests typically take longer, though they can usually be completed in a couple of weeks.

3.11 Are any regulatory or similar consents required with respect to the creation of security?

Generally no, except in the case of certain regulated entities where consent of the regulatory authority may be required for the grant or enforcement of the security interest.

Also, please see question 2.6 for a quick summary of tax issues that may arise in connection with foreign subsidiaries providing guarantees or collateral to secure loans to US borrowers.

3.12 If the borrowings to be secured are under a revolving credit facility, are there any special priority or other concerns?

Under the UCC, many traditional concerns under revolvers have been addressed by the "first to file or perfect" rule, though lenders should be aware of certain priority issues. For example, with respect to secured creditors who each have perfected security interests in UCC collateral, as stated previously certain "purchase-money" security interests and security interest in certain collateral perfected by possession or control may obtain over a security interest perfected merely by the filing of a financing statement. In addition, tax liens and some other liens created outside of the UCC may obtain priority over a UCC perfected security interest. Judgment liens may pose a priority problem for future advances, and tax liens may pose a priority problem for some after-acquired property and future advances. Otherwise, under the UCC, the first secured creditor to "file or perfect" has priority

With respect to real property, the matter is less clear. As a general matter, absent special legislation in the state, future loans may not have same priority as loans advanced when the mortgage or deed of trust is recorded if there is an intervening mortgage, deed of trust or lien recorded before the future loan is made. Accordingly, a close review of state rules and individual state documentary requirements is required in order to ensure priority.

3.13 Are there particular documentary or execution requirements (notarisation, execution under power of attorney, counterparts, deeds)?

With respect to UCC collateral, the documentation requirements are spelled out clearly in the UCC and the requirements generally are straightforward. No notarisation is required. Under prior versions of the UCC, the debtor was required to sign a written security agreement, though as the world moves away from paper and into electronic media, the model UCC, including the UCC as adopted in New York, now requires the debtor to "authenticate a record" that may include an electronic record. Nevertheless, most lenders in corporate loan transactions still generally require a written security agreement. With respect to real property collateral, the documentary and execution requirements tend to be more traditional by looking to a writing, but various law reform efforts are underway to permit electronic mortgages and deeds of trust and electronic recording of mortgages and deeds of trust. The requirements may vary significantly from state to state (for example, real property mortgages often require notarisation under state law, whereas this is generally not the case for UCC collateral).

4 Financial Assistance

4.1 Are there prohibitions or restrictions on the ability of a company to guarantee and/or give security to support borrowings incurred to finance or refinance the direct or indirect acquisition of: (a) shares of the company; (b) shares of any company which directly or indirectly owns shares in the company; or (c) shares in a sister subsidiary?

(a) Shares of the company

(b) Shares of any company which directly or indirectly owns shares in the company

(c) Shares in a sister subsidiary

Generally no. There is no "financial assistance" law *per se* in the United States, but please see the discussion of fraudulent transfer and related principles described in question 2.2.

5 Syndicated Lending/Agency/Trustee/Transfers

5.1 Will your jurisdiction recognise the role of an agent or trustee and allow the agent or trustee (rather than each lender acting separately) to enforce the loan documentation and collateral security and to apply the proceeds from the collateral to the claims of all the lenders?

Yes. In loan documentation, the role is typically that of an "agent", with bond documentation typically using a "trustee".

5.2 If an agent or trustee is not recognised in your jurisdiction, is an alternative mechanism available to achieve the effect referred to above which would allow one party to enforce claims on behalf of all the lenders so that individual lenders do not need to enforce their security separately?

This is not applicable; please see question 5.1.

5.3 Assume a loan is made to a company organised under the laws of your jurisdiction and guaranteed by a guarantor organised under the laws of your jurisdiction. If such loan is transferred by Lender A to Lender B, are there any special requirements necessary to make the loan and guarantee enforceable by Lender B?

In a syndicated lending transaction that includes a lender acting in an agency capacity, a guarantor typically would provide a guaranty to the agent "for the benefit of the lenders under the loan agreement" (or some similar formulation). As such, it should not be necessary for a guarantor to sign the transfer (assignment) documentation in order to be bound, though the contractual language should be carefully reviewed for specific requirements. In the case of a bilateral loan, the contractual terms should also be closely reviewed, though it is advisable to obtain the guarantor's consent to such assignment in any event.

6 Withholding, Stamp and other Taxes; Notarial and other Costs

6.1 Are there any requirements to deduct or withhold tax from (a) interest payable on loans made to domestic or foreign lenders, or (b) the proceeds of a claim under a guarantee or the proceeds of enforcing security?

There is no US federal income tax withholding from payments of interest or principal to US lenders, provided certain documentation requirements are complied with. With respect to the payment of interest by US borrowers to foreign lenders (other than such payments to a US branch of a foreign lender that is engaged in business in the US), the general rule is that a withholding rate of 30% is applied to the gross amount of payments constituting interest and other income. The US has in place bilateral treaties with many jurisdictions, which reduce or entirely eliminate this withholding tax for qualifying foreign lenders. A listing of these treaties is available at http://www.irs.gov/Businesses/International-Businesses/United-States-Income-Tax-Treaties---A-to-Z. Such withholding taxes may also be avoided if the requirements of the so-called "Portfolio Interest Exemption" are satisfied. This exception is generally not available to banks, but could be available to non-bank lenders such as hedge funds. Note that under FATCA (mentioned in question 1.1), foreign lenders generally will be required to identify and report directly to the US Internal Revenue Service information about accounts in such institutions that are held by US taxpayers. The failure to comply with FATCA would result in withholding as discussed in question 1.1 above even for treaty-resident lenders, which would then be required to file a refund claim pursuant to the applicable bilateral tax treaty to recoup any amounts withheld. Generally, the proceeds of a claim under a guarantee or the proceeds of enforcing security are taxed in a manner similar to payments made directly by the borrower.

6.2 What tax incentives or other incentives are provided preferentially to foreign lenders? What taxes apply to foreign lenders with respect to their loans, mortgages or other security documents, either for the purposes of effectiveness or registration?

The US federal government has generally provided few incentives targeted to foreign lenders (as there has not been a policy focus on promoting foreign loans into the United States), though please refer to the bilateral tax treaties and Portfolio Interest Exemption referred to in question 6.1.

6.3 Will any income of a foreign lender become taxable in your jurisdiction solely because of a loan to, or guarantee and/or grant of, security from a company in your jurisdiction?

In general, a foreign lender, with no presence or activities in the US, does not become subject to US federal income taxation on its net income solely as a result of loaning to, or receiving a guarantee or grant of security from, a borrower or guarantor in the US. However, income derived specifically from a loan made to a US borrower (i.e., interest and other income) would be subject to gross-basis US taxation, typically at a rate of 30%, unless a treaty specified a lower rate, or the Portfolio Interest Exemption applied (please see question 6.1). Moreover, if a foreign lender has a presence or activities in the United States (for instance, employees or agents working out of, or a lending office located in, the US), the foreign lender could be viewed as being engaged in a trade or business in the US, and if so would be subject to net-basis US taxation on any income deemed "effectively connected" with that trade or business unless an applicable treaty applied to reduce or eliminate such taxation.

6.4 Will there be any other significant costs which would be incurred by foreign lenders in the grant of such loan/guarantee/security, such as notarial fees, etc.?

With regard to mortgages and other security documents, there are generally no taxes or other costs applicable to foreign lenders that would not also be applicable to lenders in the US (please see question 3.10 for a general summary of such costs).

6.5 Are there any adverse consequences for a company that is a borrower (such as under thin capitalisation principles) if some or all of the lenders are organised under the laws of a jurisdiction other than your own? Please disregard withholding tax concerns for purposes of this question.

If a corporation is "thinly capitalised" and certain other factors are present, the US tax authorities may assert that instruments described as debt actually constitute equity for US tax purposes. The effect of such re-characterisation would be that payments on the instrument would not be deductible to the borrower for US federal income tax purposes and could be subject to withholding in a manner different than interest payments (for instance, because the Portfolio Interest Exemption would not be available). Moreover, even if treated as debt, US tax rules as amended pursuant to the 2017 Act generally limit a US taxpayer's deduction for interest on indebtedness to the sum of (a) the taxpayer's business interest income for such year, plus (b) 30% of the taxpayer's "adjusted taxable income" for such year. "Adjusted taxable income" generally means the taxpayer's EBITDA for taxable years through 2021 and the taxpayer's EBIT thereafter. The rules regarding this limitation are complex, particularly in the case of non-corporate borrowers, and may be subject to further clarifying guidance from the US Internal Revenue Service. If the lenders are organised in a jurisdiction other than that of the borrower, this should not impact the thin capitalisation analysis itself, but, as mentioned above, may impact the withholding rate as well as any relevant "gross-up".

7 Judicial Enforcement

7.1 Will the courts in your jurisdiction recognise a governing law in a contract that is the law of another jurisdiction (a "foreign governing law")? Will courts in your jurisdiction enforce a contract that has a foreign governing law?

Generally, yes, so long as the choice of law bears a "reasonable relation" to the transaction and application of the foreign governing law would not be contrary to the public policy of the forum state.

On a related note, in connection with a choice of *New York* law as a governing law, a New York statute allows for New York law to be chosen by parties to a contract and, with certain exceptions, such choice of law will be given effect by New York courts if the transaction exceeds $250,000 in value, regardless of whether the choice of New York law bears any reasonable relationship to the transaction. (The choice of New York as a forum is subject to additional requirements under the statute.) California has a similar statute.

7.2 Will the courts in your jurisdiction recognise and enforce a judgment given against a company in New York courts or English courts (a "foreign judgment") without re-examination of the merits of the case?

In most instances, yes. Despite the strong commercial ties between the United States and the United Kingdom, there is no international treaty on reciprocal recognition and enforcement of court judgments (attempts to come to terms on a bilateral treaty in 1981 broke down over the negotiation of the final text). Nevertheless, the Uniform Foreign Country Money Judgments Recognition Act has been adopted by most states (including New York) and sets out basic rules of enforceability in connection with the enforcement of judgments between states in the United States, with "foreign-country" judgments treated in a similar manner as the judgment of a sister state. Generally, if a judgment is obtained in accordance with procedures compatible with United States due process principles, it will be recognised under the Uniform Act. There are many examples of English judgments having been enforced in New York courts.

7.3 Assuming a company is in payment default under a loan agreement or a guarantee agreement and has no legal defence to payment, approximately how long would it take for a foreign lender to (a) assuming the answer to question 7.1 is yes, file a suit against the company in a court in your jurisdiction, obtain a judgment, and enforce the judgment against the assets of the company, and (b) assuming the answer to question 7.2 is yes, enforce a foreign judgment in a court in your jurisdiction against the assets of the company?

In New York, a court could rule almost immediately, perhaps within three to six months or less, with enforcement against assets of the company in New York beginning as soon as the judgment was entered (unless the defendant obtained a stay of enforcement). However, in practice, particularly if an opposing party appears and raises procedural or other issues, matters could take materially longer, up to a year or more.

Enforcement of a foreign judgment is generally pursued in New York by having the foreign judgment "confirmed", with time frames similar to those mentioned above.

7.4 With respect to enforcing collateral security, are there any significant restrictions which may impact the timing and value of enforcement, such as (a) a requirement for a public auction, or (b) regulatory consents?

In a non-bankruptcy context, the timing and restrictions that apply to enforcement of collateral can vary significantly, depending on the type of collateral and relevant state law that applies. The UCC provides a great deal of flexibility in the rules governing disposition of personal property collateral (see question 3.1). The UCC generally permits either "private" or "public" sale, with the only real limitation on the power to sell that the secured party must "act in good faith" and in a "commercially reasonable manner". Under the UCC, after the sale, the secured party generally may pursue the debtor for amounts that remain unpaid (the "deficiency"). The requirements with respect to real property collateral will vary significantly from state to state (and note in particular that in California, there may be limitations with respect the ability of a creditor to collect on a deficiency if the creditor is secured with real property collateral). With respect to regulated entities (including certain energy and communications companies) enforcement may require regulatory approval.

In a bankruptcy context, enforcement would be restricted by the automatic stay (please see question 8.1).

7.5 Do restrictions apply to foreign lenders in the event of (a) filing suit against a company in your jurisdiction, or (b) foreclosure on collateral security?

For the most part, distinctions will not be made between foreign and domestic creditors in such proceedings. However, there are certain issues a foreign lender would need to consider in connection with such activities. For example, generally a foreign creditor will need to be authorised to do business in New York before availing itself as a plaintiff of the New York courts. In addition, foreign creditors may be subject to federal or state limitations on or disclosure requirements for the direct or indirect foreign ownership of certain specific types of companies or collateral, including in the energy, communications and natural resources areas.

7.6 Do the bankruptcy, reorganisation or similar laws in your jurisdiction provide for any kind of moratorium on enforcement of lender claims? If so, does the moratorium apply to the enforcement of collateral security?

Yes, please see question 8.1.

7.7 Will the courts in your jurisdiction recognise and enforce an arbitral award given against the company without re-examination of the merits?

The United States is party to the New York Convention. As set forth in the Convention, the Convention requires courts of contracting states to give effect to private agreements to arbitrate and to recognise and enforce arbitration awards made in other contracting states, subject to certain limitations and/or potential challenges. Note, however, that loan agreements under New York law generally do not include arbitration clauses.

8 Bankruptcy Proceedings

8.1 How does a bankruptcy proceeding in respect of a company affect the ability of a lender to enforce its rights as a secured party over the collateral security?

In the US, a bankruptcy proceeding may be initiated by either the company (debtor) itself or by its creditors. Once the proceeding is commenced, the relevant statutes in the United States (the "Bankruptcy Code") provide that an "automatic stay" immediately occurs. This automatic stay is effectively a court order that prevents creditors from taking any actions against the debtor or its property, including enforcement actions against collateral. A creditor that violates the automatic stay could face severe penalties, including actual damages caused to the debtor and other creditors, as well as having its enforcement action declared void (punitive damages are typically limited to individual, rather than corporate debtors).

There are, however, a number of protections for a secured creditor who has properly perfected its liens and such liens are not subject to avoidance. First and foremost, upon a liquidation of a debtor, a secured creditor is paid its claim (up to the value of its collateral) prior to the payment of general unsecured creditors or, alternatively, it may receive its collateral back in satisfaction of its secured claim. Also, in the case of a reorganisation of a debtor, cash collateral cannot be used by the debtor without specific authorisation from the bankruptcy court or consent of the secured party, and in other circumstances the Bankruptcy Code mandates that a secured party's interest in its collateral be "adequately protected".

8.2 Are there any preference periods, clawback rights or other preferential creditors' rights (e.g., tax debts, employees' claims) with respect to the security?

In short, yes. A lender's security interest could be voided as a "preferential transfer" if it is provided to the lender within 90 days before a bankruptcy filing (or one year if the lender is an "insider," or related party of the debtor) and as a result of the transfer the lender receives more than it would have otherwise received in the liquidation of the debtor. There are a number of exceptions to this rule, including where there has been a substantially contemporaneous exchange for new value. Please also see the discussion of "fraudulent transfers" in question 2.2.

There are certain claims that may have priority even over a properly perfected security interest, including tax liens, mechanics lines, and certain costs associated with the bankruptcy itself.

8.3 Are there any entities that are excluded from bankruptcy proceedings and, if so, what is the applicable legislation?

There are a number of entities that are either excluded from the Bankruptcy Code or for which special provisions of the Bankruptcy Code or other special legislation apply, including banks, insurance companies, commodity brokers, stockbrokers and government entities and municipalities. Municipalities and government-owned entities (but not states themselves) are eligible for relief under Chapter 9 of the Bankruptcy Code.

8.4 Are there any processes other than court proceedings that are available to a creditor to seize the assets of a company in an enforcement?

Yes. The UCC allows for so-called "self-help" remedies without first commencing a court proceeding. Note that the relevant provisions of a security agreement and governing law should be considered before exercising these types of remedies. These remedies typically can only be used so long as no "breach of the peace" would occur. Subject to the above, the market generally accepts these types of remedies for collateral, such as bank accounts and certificated securities.

9 Jurisdiction and Waiver of Immunity

9.1 Is a party's submission to a foreign jurisdiction legally binding and enforceable under the laws of your jurisdiction?

Generally, yes.

9.2 Is a party's waiver of sovereign immunity legally binding and enforceable under the laws of your jurisdiction?

Yes. The Foreign Sovereign Immunities Act ("FSIA") codifies the law of sovereign immunity in the US. The FSIA allows for such immunity to be waived, and generally upholds waivers, with some limitations (for example, non-commercial property of a sovereign cannot be attached). Certain organisations also receive immunity under authority separate from the FSIA: the International Organizations Immunity Act covers immunity for certain institutions like the IMF, the OECD and the African Union. One issue in connection with the enforcement of such waivers is whether a borrower actually had the immunity to waive when it provided a waiver. Such scenarios arise in the context of the nationalisation of a company. In such a case, a company may not have had any immunity to waive (since it was not previously owned by the state) when it entered into the loan, so any waiver provided prior to being taken over by a state may be considered void. For this reason, New York law-governed loan agreements often include a representation that a loan represents a "commercial act", which excludes the transaction from protection under relevant immunity statutes, whether or not such immunity was in fact effectively waived.

10 Licensing

10.1 What are the licensing and other eligibility requirements in your jurisdiction for lenders to a company in your jurisdiction, if any? Are these licensing and eligibility requirements different for a "foreign" lender (i.e. a lender that is not located in your jurisdiction)? In connection with any such requirements, is a distinction made under the laws of in your jurisdiction between a lender that is a bank versus a lender that is a non-bank? If there are such requirements in your jurisdiction, what are the consequences for a lender that has not satisfied such requirements but has nonetheless made a loan to a company in your jurisdiction? What are the licensing and other eligibility requirements in your jurisdiction for an agent under a syndicated facility for lenders to a company in your jurisdiction?

In the US, a lender is not required to be a bank (indeed, many lenders are non-banks). A lender should be aware of any relevant state lending licensing laws which may require a lender to be licensed. In general, regulated banks do not need to be separately licensed under state law as lenders, but nonbank lenders must be aware of, and comply with, applicable lender licensing laws. These licensing laws are much more stringent in the consumer or "small loan" lending area than in the commercial or corporate lending area (where few states require the licensing of corporate nonbank lenders, California being a notable exception), although in any event nonbank lender licences are typically easier to obtain than a "banking licence".

In general, the applicability of state licensing laws is triggered by the solicitation of loans with, or the making of loans to, residents of that state. Therefore, whether a lender is a U.S. or non-U.S. lender generally has no bearing on whether that lender must be licensed under the laws of a given state. In some cases, one needs to be "in the business of making loans" in order for the licensing statute to be given effect (for example, the New York lender licensing law indicates those lenders who engage in "isolated, incidental or occasional transactions" are not "in the business of making loans" and therefore not covered for purposes of the statute).

Non-compliance with a licence statute could have a material impact on the lender, from not being able to access a state's court system to having a loan be determined to be unenforceable. Whether an agent on a lending transaction would also need to be licensed will depend on the wording of each state's particular statute.

Note there are often contractual restrictions in New York law-governed loan documentation that require a lender be a certain type of organisation that is in the business of making loans. The rationale for this is many-fold, from securities law concerns to the preference of the borrower to only deal with sophisticated financial institutions should the loan be sold.

11 Other Matters

11.1 Are there any other material considerations which should be taken into account by lenders when participating in financings in your jurisdiction?

The material considerations to be considered in connection with a financing in the US will vary depending on the type of financing and the parties involved, and a discussion with counsel is encouraged before entering into any financing in the US. However, the above questions address many of the main material issues that arise.

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Venezuela

Rodner, Martínez & Asociados

Jaime Martínez Estévez

1 Overview

1.1 What are the main trends/significant developments in the lending markets in your jurisdiction?

Domestic lending activities are, to a large extent, determined by compulsory lending mandated by the law and regulations for the housing, tourism, agriculture and industrial sectors of the economy. International lending has been substantially diminished given the political circumstances, including the U.S. sanctions, and has been mainly circumscribed to the financing of Government projects and, particularly, further development of the Orinoco heavy oil basin.

1.2 What are some significant lending transactions that have taken place in your jurisdiction in recent years?

Lending transactions are mostly restructurings and supplemental financing in the oil sector, particularly though joint venture companies chartered by PDVSA (a Venezuelan national oil company) and foreign oil companies, in which PDVSA owns the majority of the shares, and trade financing for Venezuelan imports.

2 Guarantees

2.1 Can a company guarantee borrowings of one or more other members of its corporate group (see below for questions relating to fraudulent transfer/financial assistance)?

There are no particular legal restrictions for intercompany loans. However, tax provisions on presumed dividends and transfer pricing may be applicable.

2.2 Are there enforceability or other concerns (such as director liability) if only a disproportionately small (or no) benefit to the guaranteeing/securing company can be shown?

No, absent a conflict with the corporate charter or an insolvency situation.

2.3 Is lack of corporate power an issue?

Definitely. If there is no capacity to issue the consent, the act would not be valid (Article 1141 of the Civil Code and Articles 243 and 270 of the Commercial Code).

2.4 Are any governmental or other consents or filings, or other formalities (such as shareholder approval), required?

No governmental consent or filing is required. Shareholder approval would be necessary if the respective charter and by-laws establish that the power to guarantee third-party obligations rests on the shareholders.

2.5 Are net worth, solvency or similar limitations imposed on the amount of a guarantee?

None, except that the enforceability of the guarantee could be set aside if given while insolvent (Article 946 of the Commercial Code).

2.6 Are there any exchange control or similar obstacles to enforcement of a guarantee?

There has been an exchange control in effect since 2003. Formally, the exchange control was eliminated with Exchange Agreement No. 1 published on September 7, 2018, which establishes that there is free convertibility, but the system continues to be dependent on the rate reported by the Central Bank and auctions administered by it, which mean that the restrictions to access foreign currency remain practically unaltered. The foreign exchange system has been modified several times and has repeatedly been proven inefficient. There is no prohibition of Venezuelan companies holding foreign currency assets abroad. If the guarantor has foreign currency funds abroad, it can make the payment in foreign currency without authorisation. Government-controlled entities require Central Bank authorisation to hold foreign currency abroad.

3 Collateral Security

3.1 What types of collateral are available to secure lending obligations?

Security interest can be created over tangible and intangible assets, including real estate, chattel property, inventory, a business establishment, credit rights, intellectual property rights, shares and other securities.

3.2 Is it possible to give asset security by means of a general security agreement or is an agreement required in relation to each type of asset? Briefly, what is the procedure?

Depending on the type of collateral, the security interest document will vary. Some security interest can be created by way of a mortgage (e.g. real estate, chattel property) and others pursuant to a pledge (e.g. shares, account receivables). Some require governmental authorisation and special filings. A single security interest document can cover different types of collateral and forms of encumbrance (mortgage, pledge without transfer of possession). Registrations of the same security interest document may be done in registries of various municipal jurisdictions.

3.3 Can collateral security be taken over real property (land), plant, machinery and equipment? Briefly, what is the procedure?

A real estate mortgage may cover the land and the plant (governed by the Civil Code, Article 1877), and the machinery and equipment may be covered by a chattel mortgage (governed by the Chattel Mortgage and Pledge Without Transfer of Possession Act). The mortgage document must be registered in the registry with jurisdiction over the location of the assets.

3.4 Can collateral security be taken over receivables? Briefly, what is the procedure? Are debtors required to be notified of the security?

Security interest may be taken over receivables by way of a pledge. The pledge agreement must be executed before a notary or filed with a notary (to have a certain date). Notice must be given to the debtors (notice of transfer as security interest, Article 1550 of the Civil Code).

3.5 Can collateral security be taken over cash deposited in bank accounts? Briefly, what is the procedure?

A pledge agreement can be entered into in connection with the rights associated with a bank or brokerage account. Notice must be given to the bank or brokerage entity holding the account.

3.6 Can collateral security be taken over shares in companies incorporated in your jurisdiction? Are the shares in certificated form? Can such security validly be granted under a New York or English law governed document? Briefly, what is the procedure?

Shares of a Venezuelan corporation may be pledged. In addition to executing a pledge agreement, a transfer as security interest note should be inscribed in the shareholders' registry book of the corporation. Share certificates are commonly issued (Article 293 of the Commercial Code). However, the transfer of the rights of a shareholder is done by a note in the shareholders' registry book (Article 296 of the Commercial Code). The agreement must be governed by Venezuelan law (Articles 20, 27 and 37 of the International Private Law Act).

3.7 Can security be taken over inventory? Briefly, what is the procedure?

Security interest can be taken over inventory by way of a chattel mortgage (Article 30 of the Chattel Mortgage and Pledge Without Transfer of Possession Act) or pursuant to an arrangement with an authorised general warehouse and delivery of warehouse certificates (in accordance with the General Deposit Warehouses Act).

3.8 Can a company grant a security interest in order to secure its obligations (i) as a borrower under a credit facility, and (ii) as a guarantor of the obligations of other borrowers and/or guarantors of obligations under a credit facility (see below for questions relating to the giving of guarantees and financial assistance)?

A security interest can be granted to several creditors and for different transactions. However, if different creditors are receiving a security interest with respect to different transactions, ranking of the security interest and inter-creditor agreements may be necessary.

3.9 What are the notarisation, registration, stamp duty and other fees (whether related to property value or otherwise) in relation to security over different types of assets?

The notarisation charges for documents creating security interest are not calculated based on the type or value of the assets but rather on the particulars of the document (e.g. number of pages). Registrations of security interests, however, generate fees which are calculated based on the value assigned to the security interest. The registration fees will be calculated pursuant to a progressive rate of up to 0.60% (Article 83 of the Public Registry and Notary Act).

3.10 Do the filing, notification or registration requirements in relation to security over different types of assets involve a significant amount of time or expense?

When authorisations are required, the procedure may be a lengthy one. Registration of complex transactions may also require extra time. When the assets are located in different jurisdictions, the security interest document may need to be registered in all of the registries with jurisdiction over the different locations, which may prove to be a long process.

3.11 Are any regulatory or similar consents required with respect to the creation of security?

Chattel mortgages and pledges without transfer of possession can only be created in favour of qualified secured creditors, including foreign banks authorised by the Superintendency of the Banking Sector Institutions (Article 19 of the Chattel Mortgage and Pledge Without Transfer of Possession Act). To request such an authorisation, a draft of the security interest document must be presented.

3.12 If the borrowings to be secured are under a revolving credit facility, are there any special priority or other concerns?

There is no problem in creating a security interest with respect to a revolving credit facility. Priority of mortgages will be set by the date of registration.

3.13 Are there particular documentary or execution requirements (notarisation, execution under power of attorney, counterparts, deeds)?

Mortgage documents must be registered. Registration must be done in the registry office with jurisdiction given by the location or the type of asset. Pledges are to be executed before a notary or a counterpart of the pledge agreement must be filed with a notary soon after.

4 Financial Assistance

4.1 Are there prohibitions or restrictions on the ability of a company to guarantee and/or give security to support borrowings incurred to finance or refinance the direct or indirect acquisition of: (a) shares of the company; (b) shares of any company which directly or indirectly owns shares in the company; or (c) shares in a sister subsidiary?

(a) Shares of the company

Guarantees and security interest can be provided to support financing for the acquisition of shares, except that there is a prohibition on making loans or giving security interest for the acquisition of its own shares. The prohibition originates from the provision regarding Treasury shares, which establishes that the company cannot purchase its own shares except with amounts corresponding to retained earnings (Article 263 of the Commercial Code). A more evolved and far-reaching provision is found in the Securities Market Act of 2015 (Article 72).

(b) Shares of any company which directly or indirectly owns shares in the company

Case law has expanded the above-mentioned prohibition to preclude transactions that pretend to bypass the prohibition by using interposed persons.

(c) Shares in a sister subsidiary

The comment for (b) above applies here as well.

5 Syndicated Lending/Agency/Trustee/Transfers

5.1 Will your jurisdiction recognise the role of an agent or trustee and allow the agent or trustee (rather than each lender acting separately) to enforce the loan documentation and collateral security and to apply the proceeds from the collateral to the claims of all the lenders?

A security agent could be created, empowering such agent to act on behalf of all the secured lenders. However, the secured interest must be created in favour of the secured lenders. The security agent may also serve as payment agent and be authorised to receive payments and to make distributions of such payments among the secured lenders.

5.2 If an agent or trustee is not recognised in your jurisdiction, is an alternative mechanism available to achieve the effect referred to above which would allow one party to enforce claims on behalf of all the lenders so that individual lenders do not need to enforce their security separately?

This is not applicable. See the answers above.

5.3 Assume a loan is made to a company organised under the laws of your jurisdiction and guaranteed by a guarantor organised under the laws of your jurisdiction. If such loan is transferred by Lender A to Lender B, are there any special requirements necessary to make the loan and guarantee enforceable by Lender B?

Notice must be given to the debtor and the guarantor if an assignment of a loan takes place (Article 1550 of the Civil Code and 150 of the Commercial Code). The transaction documents may establish additional conditions for the transferability of a loan.

6 Withholding, Stamp and Other Taxes; Notarial and Other Costs

6.1 Are there any requirements to deduct or withhold tax from (a) interest payable on loans made to domestic or foreign lenders, or (b) the proceeds of a claim under a guarantee or the proceeds of enforcing security?

Interest payments are subject to withholding tax when made to foreign lenders (Article 9 (3) of Decree 1808 of 1997). Interest payments to local banks are not subject to withholding (Article 10 of Decree 1808). Guarantee and proceeds of enforcing a security interest are not subject to withholding, unless deemed allocated to the payment of interest.

6.2 What tax incentives or other incentives are provided preferentially to foreign lenders? What taxes apply to foreign lenders with respect to their loans, mortgages or other security documents, either for the purposes of effectiveness or registration?

Currently, there are no tax incentives for foreign lenders. From time to time, exonerations are given to induce the financing of projects in certain economic sectors. Interests on loans made by foreign financial institutions are taxed at the rate of 4.95% (Article 52 of the Income Tax Act). Other rates may apply because of tax treaties. The stamp taxes and fees that are to be paid for the documentation of a loan or a security interest are the same for local and foreign lenders.

6.3 Will any income of a foreign lender become taxable in your jurisdiction solely because of a loan to, or guarantee and/or grant of, security from a company in your jurisdiction?

Income originating from loans made to Venezuelan borrowers is subject to Venezuelan income tax at a rate of 4.95% (Article 52 of the Income Tax Act). The borrower is to withhold the tax when making the interest payments. If the guarantor or the owner of the security interest is a Venezuelan corporation, no Venezuelan tax will apply to the loan solely because of such circumstance.

6.4 Will there be any other significant costs which would be incurred by foreign lenders in the grant of such loan/guarantee/security, such as notarial fees, etc.?

There are no significant costs associated with the execution of documentation related to a loan, guarantee or security interest, except that the registration of the security interest will entail the payment of registration fees based on a progressive tariff of up to 0.60% of the value of the security interest (Article 83 of the Public Registry and Notary Act).

6.5 Are there any adverse consequences for a company that is a borrower (such as under thin capitalisation principles) if some or all of the lenders are organised under the laws of a jurisdiction other than your own? Please disregard withholding tax concerns for purposes of this question.

No, there are none.

7 Judicial Enforcement

7.1 Will the courts in your jurisdiction recognise a governing law in a contract that is the law of another jurisdiction (a "foreign governing law")? Will courts in your jurisdiction enforce a contract that has a foreign governing law?

Venezuelan courts will recognise a foreign governing law if it is selected as the governing law of a contract (Article 29 of the International Private Law Act). Venezuelan courts will enforce such a contract in Venezuela. However, there may be some exceptions for national interest contracts and public policy reasons (Article 151 of the Constitution and Article 5 of the International Private Law Act).

7.2 Will the courts in your jurisdiction recognise and enforce a judgment given against a company in New York courts or English courts (a "foreign judgment") without re-examination of the merits of the case?

Passing of a foreign judgment requires a procedure before the Supreme Court (*exequatur*), which excludes the examination of the merits (Articles 53 of the International Private Law Act and 850 of the Civil Procedure Code). For arbitral awards, the 1958 New York Convention on the Recognition and Enforcement of Foreign Arbitral Awards will apply.

7.3 Assuming a company is in payment default under a loan agreement or a guarantee agreement and has no legal defence to payment, approximately how long would it take for a foreign lender to (a) assuming the answer to question 7.1 is yes, file a suit against the company in a court in your jurisdiction, obtain a judgment, and enforce the judgment against the assets of the company, and (b) assuming the answer to question 7.2 is yes, enforce a foreign judgment in a court in your jurisdiction against the assets of the company?

A procedure for collection of amounts due may take up to approximately two years, depending on the defences and appeals that the defendant raises during the court procedures. An *exequatur* procedure, for the passing of a foreign judgment, may take between one and two years and the enforcement against assets of the defendant in Venezuela may take between six months and one year.

7.4 With respect to enforcing collateral security, are there any significant restrictions which may impact the timing and value of enforcement, such as (a) a requirement for a public auction, or (b) regulatory consents?

Venezuelan enforcement procedures will require a public auction (Articles 550 to 584 of the Civil Procedure Code). Notices to the Attorney General's Office will be required if there is a risk of interruption of a public service (Article 99 of the Attorney General Organic Act). The existing exchange control is one of the major obstacles to effectively realise the proceeds of the security interest being enforced.

7.5 Do restrictions apply to foreign lenders in the event of (a) filing suit against a company in your jurisdiction, or (b) foreclosure on collateral security?

This is not applicable. In non-commercial litigations, the foreign plaintiff may be required to post a bond (Articles 36 of the Civil Code and 1102 of the Commercial Code).

7.6 Do the bankruptcy, reorganisation or similar laws in your jurisdiction provide for any kind of moratorium on enforcement of lender claims? If so, does the moratorium apply to the enforcement of collateral security?

If the debtor has a positive network but has liquidity problems, it may apply for a moratorium (Article 898 of the Commercial Code). While in moratorium or in a bankruptcy procedure, the enforcement of rights against the debtor would be suspended, except that the suspension would not apply to the enforcement of security interest (Articles 905, 942 and 964 of the Commercial Code).

7.7 Will the courts in your jurisdiction recognise and enforce an arbitral award given against the company without re-examination of the merits?

Yes. Venezuela is a party to the 1958 New York Convention on the Recognition and Enforcement of Foreign Arbitral Awards.

8 Bankruptcy Proceedings

8.1 How does a bankruptcy proceeding in respect of a company affect the ability of a lender to enforce its rights as a secured party over the collateral security?

The secured lender would be limited in its ability to collect from the bankruptcy assets, other than the collateral, if the collateral is not sufficient to satisfy its claims (Article 1047 of the Commercial Code). If the collateral is not sufficient to satisfy the debt, the bankruptcy effects will apply to the remaining debt, including that interest stop accruing on the bankruptcy declaration date (Articles 943 and 944 of the Commercial Code).

8.2 Are there any preference periods, clawback rights or other preferential creditors' rights (e.g., tax debts, employees' claims) with respect to the security?

There are debts that are preferred by law (privileged creditors, Article 1867 of the Civil Code; labour debts, Article 151 of the Labour and Workers Act), even above the preference corresponding to secured creditors. Security interest granted during the so-called suspicious period may be set aside. A suspicious period may be up to two years and 10 days (Articles 936 and 945 of the Commercial Code). The suspicious period begins 10 days prior to the date on which the court establishes that the insolvency commenced. Payments on unmatured debt or in kind made during the suspicious period may be annulled (Article 945 of the Commercial Code).

8.3 Are there any entities that are excluded from bankruptcy proceedings and, if so, what is the applicable legislation?

Banks, insurance companies and brokerage houses are excluded from bankruptcy and subject to a similar procedure carried by the Superintendency of the Banking Sector Institutions (Articles 240, 247 and 257 of the Banking Sector Institutions Act), the Superintendency of Insurance Activity (Articles 98, 101 and 107 of the Insurance Activity Act) or the National Securities Superintendency (Article 135 of the Securities Market Act), respectively.

8.4 Are there any processes other than court proceedings that are available to a creditor to seize the assets of a company in an enforcement?

No (Articles 1844 of the Civil Code and 542 of the Commercial Code), except for retention rights (Articles 122 and 148 of the Commercial Code) and the collection of credits given as collateral (Article 538 of the Commercial Code).

9 Jurisdiction and Waiver of Immunity

9.1 Is a party's submission to a foreign jurisdiction legally binding and enforceable under the laws of your jurisdiction?

Yes, provided that it is a commercial transaction and the exceptions of national interest contract (Article 151 of the Constitution), Venezuela real estate or public policy (Article 47 of the International Private Law Act) do not apply.

9.2 Is a party's waiver of sovereign immunity legally binding and enforceable under the laws of your jurisdiction?

Yes, subject to the same conditions mentioned in question 9.1.

10 Licensing

10.1 What are the licensing and other eligibility requirements in your jurisdiction for lenders to a company in your jurisdiction, if any? Are these licensing and eligibility requirements different for a "foreign" lender (i.e. a lender that is not located in your jurisdiction)? In connection with any such requirements, is a distinction made under the laws of your jurisdiction between a lender that is a bank *versus* a lender that is a non-bank? If there are such requirements in your jurisdiction, what are the consequences for a lender that has not satisfied such requirements but has nonetheless made a loan to a company in your jurisdiction? What are the licensing and other eligibility requirements in your jurisdiction for an agent under a syndicated facility for lenders to a company in your jurisdiction?

There are no eligibility requirements for lenders. However, the nature of the lender may be relevant for the purposes of determining the applicable income tax regime (e.g. a 4.95% tax rate applies to interest payments to foreign financial institutions, a 34% tax rate on net income of non-bank lenders (absent a tax treaty provision) and a 40% tax rate applies on net income of local financial institutions). There is no need for the lenders to be licensed or authorised to do business in Venezuela. They do not need to be a licensed bank in the jurisdiction of incorporation.

There are differences between the authorisations required to be a beneficiary of a chattel mortgage and pledge without transfer of possession, depending on the type of lender. No authorisation is required if the lender is a local bank. Authorisation from the Superintendency of the Banking Sector Institutions will be necessary if it is a foreign bank. Authorisation from the Ministry of Agriculture or the Ministry of Communications may be needed for certain security interests in favour of other types of lenders.

For trusts created in Venezuela, the trustee must be a local bank or insurance company, authorised to operate as such and to serve as trustee, by the Superintendency of the Banking Sector Institutions and by the Superintendency of Insurance Activities.

11 Other Matters

11.1 Are there any other material considerations which should be taken into account by lenders when participating in financings in your jurisdiction?

Special consideration must be given to the difficulties of converting local currency to foreign currency.

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