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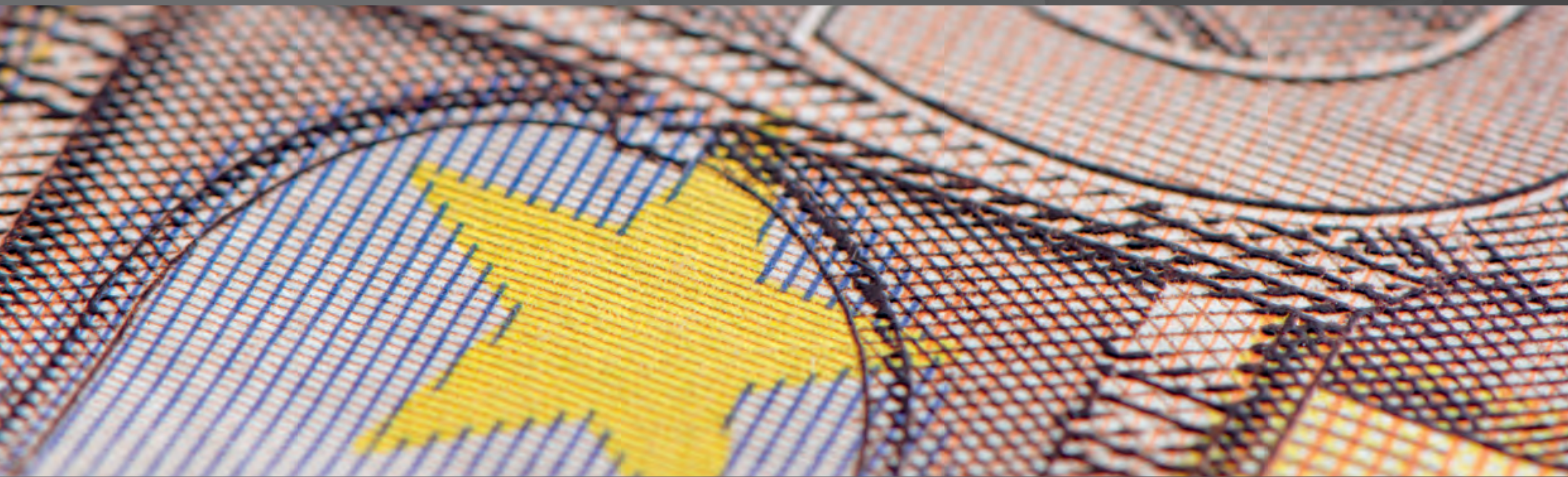

Lending & Secured Finance 2020

A practical cross-border insight into lending and secured finance

Eighth Edition

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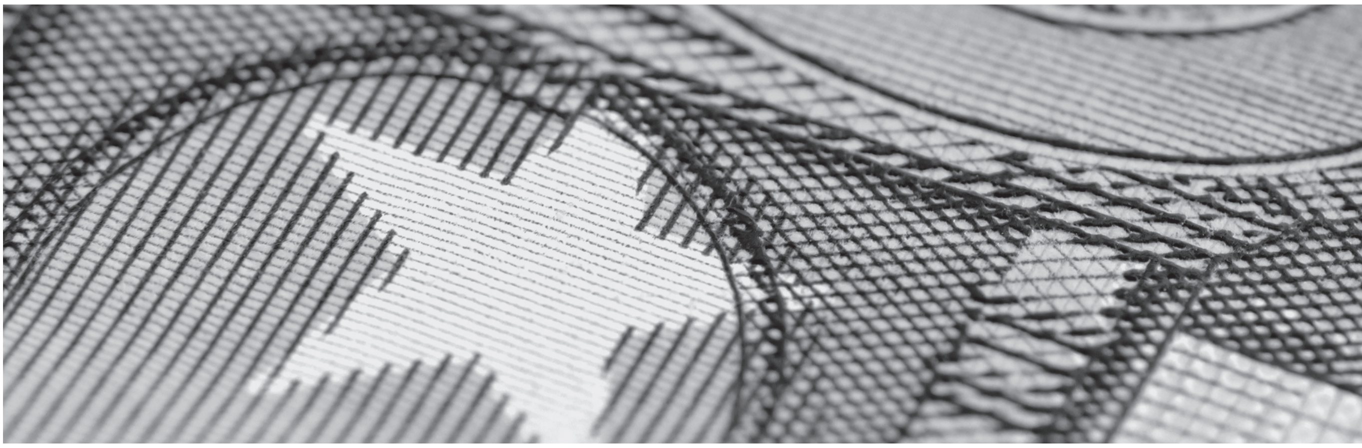

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Q&A Chapters

Q&A Chapters Continued

Preface

Welcome to the 2020 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 seven editions established it as one of the most comprehensive guides in the practice of cross-border lending. This eighth edition includes contributions from the LSTA, the LMA and the APLMA, covers 40 jurisdictions and includes numerous overview chapters written by leading practitioners. In addition, we are delighted to include contributions from in-house counsel at HSBC and Credit Agricole to this eighth edition. The participation of in-house counsel at global financial institutions 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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Tess Virmani

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 2019, total corporate lending in the United States surpassed $2.1 trillion,[1] representing a decrease in volume from the previous year. 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 $950 billion in 2019, a slight decrease from 2018 volumes. 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 $807 billion.[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 $350 billion.[4]

Of these three market segments, it is the leveraged loan market that has evolved most dramatically over the past 30–35 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 since the global financial crisis, 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 by-product 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 promotes 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 more than 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% and accounted for more than 50% 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% 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 $743 billion in 2019.

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 benefitted 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% 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 more recently published a detailed form of term sheet. Finally, the LSTA continues to expand its suite of documents for making, trading, and settling loans to borrowers domiciled in four jurisdictions in Latin America: Chile; Colombia; Peru; and Mexico.

Leaving LIBOR and Going Green? The Loan Market in 2020

Looking back at 2019, two topics grabbed the attention of market participants: first, the impending phase-out of LIBOR and preparations for the transition to replacement benchmarks; second, on a more positive note, the continued growth of sustainable finance in the Americas (and globally) and the emergence of ESG in the loan market. These trends are discussed in detail below.

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). Once the ARRC focused on cash products, like loans, in early 2018, the first order of business was the development of robust fallback language. Given that market participants would still need to be referencing LIBOR for new transactions until replacement benchmarks were available, it was essential that credit agreements explicitly addressed the discontinuation of LIBOR. The ARRC released fallback language recommendations for syndicated loans and bilateral loans in April and June, respectively. Fallback language is simply the contractual language that informs parties what reference rate they will use if LIBOR is no longer available. The ARRC recommendations provide for two approaches – an amendment approach and a hardwired approach which uses predetermined terms – and the amendment approach recommendation (or language very similar) has been widely adopted in the syndicated loan market. This approach makes sense given the relative flexibility of corporate loans and the uncertainty around replacement benchmarks. However, looking at 2020, a move to a hardwired fallback approach may be the prudent option. Hardwired fallback language provides pre-negotiated operative replacement benchmark terms so there is no need for obtaining consents from credit agreement parties at the time LIBOR becomes unavailable. In contrast to the amendment approach which is essentially a streamlined "agreement to agree" in the future, hardwired language is decided upfront. Generally, once a trigger event occurs, such as the cessation of LIBOR or LIBOR is found to be no longer representative, embedded replacement benchmark and spread adjustment (if necessary) waterfalls dictate what the benchmark will be going forward. Unlike other asset classes, like floating rate notes and CLOs, that have embraced hardwired fallback language, the loan market has been reluctant to do so due to uncertainty around replacement benchmarks. For instance, what are the appropriate steps in the waterfalls? What would a spread adjustment for the transition away from LIBOR look like? Are institutions operationally prepared? All of these questions are valid – and set to be answered this year. Loan market participants are familiarising themselves with replacement benchmarks, such as SOFR for USD LIBOR, and what variant of SOFR might be suitable for loans. The ARRC has committed to developing a spread adjustment to use in fallback language and has launched a consultation on the methodology that might be used. Finally, the LSTA has been working with the loan vendor community to help ensure that systems would be ready to accommodate different SOFR variants by the end of the year. In light of the information pieces that are becoming available, market participants should carefully consider whether the large-scale transition of loans to replacement benchmarks is operationally feasible in a short amount of time once LIBOR ceases. That being said, while the adoption of hardwired fallback language would be welcome, fallback language is an imperfect solution and the smoothest transition away from LIBOR is certainly through originating non-LIBOR referencing loans. This may be some time away, but the LSTA is working with members to develop "concept credit agreements" for two of the variants of SOFR that are likely to be used: compounded SOFR in arrears; and simple SOFR in arrears. The hope is that these concept documents can then help educate market participants on what a non-LIBOR syndicated loan might look like. What we know for sure is that 2020 will be busy with LIBOR transition efforts, but hopefully by the end of the year, the loan market is truly ready for life after 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 sustainability considerations find their way into nearly all aspects of our consciousness—whether at a corporate or individual level. This trend has manifest itself primarily in two ways in the loan market: the growth of sustainability linked loans; and the increased focus of ESG in credit ratings and in understanding a company's broader risk profile.

According to Refinitiv LPC, nearly $167 billion in green loans and sustainability linked loans came to the global loan market in 2019—about 2.5 times more volume than was seen in 2018. Of that 2019 activity, more than $135 billion represented sustainability linked loans. A sustainability linked loan (SLL) economically incentivises the borrower, typically through margin, to achieve ambitious, predetermined sustainability performance targets (SPTs). The loans are not pure green financings – like green loans – but they are an important form of specialised financing to help companies make the transition to more sustainable business models. In this way they stand apart as a transition tool and an SLL could be made to any company that has a sustainability plan and it will reward that company for achieving the goals set out in that plan. In light of the rapid global growth of SLLs, in March 2019 the LSTA, LMA and APLMA published a voluntary framework to categorise these loans and preserve the integrity of this loan product. The Sustainability Linked Loan Principles are a high-level framework that identifies four core components for sustainability-linked loans: 1) relationship of the selected SPTs to the borrower's overall CSR strategy; 2) target setting; 3) reporting on the borrower's performance with respect to the relevant SPTs; and 4) the need for external review which is negotiated on a deal-by-deal basis. A successful SLL fits into and complements a borrower's existing sustainability strategy. In structuring an SLL, attention to the selection of the sustainability metrics and setting of the SPTs is key—they need to be identifiable, ambitious, meaningful to the borrower's business and, perhaps most importantly, readily measurable. Given that these loans do not have a use of proceeds determinant, like green loans, we would expect the growth of this loan product to continue going forward.

Over the last 12 months, the LSTA has focused on the impact of ESG (environmental, social and governance) considerations on the corporate loan market. Generally, we know that companies and their investors across the financial markets are increasingly focused on how ESG factors impact their businesses. This trend is equally true in the loan market. For many investors and lenders, being aware of the ESG risks a company faces – and the way in which these risks are being addressed – is critical to understanding a company's broader risk profile. Moreover, end investors are regularly requiring asset managers to illustrate how ESG factors inform their investment decisions. In fact, according to a 2018 UNPRI report, 86% of asset owners are considering ESG/active ownership when selecting asset managers (a 31% increase from 2017) and 78% when monitoring their asset managers (a 25% increase YoY). Moreover, over 80% of investors have sustainable, impact or ESG policies. While obtaining reliable ESG information about companies is something investors struggle with across asset classes, the fact that many borrowers in the loan market are not public companies exacerbates the challenge. For this reason, at the request of, and in collaboration with, buyside members, the LSTA developed the ESG Diligence Questionnaire. The Questionnaire was launched in February 2020 and is designed to be completed by a borrower during the due diligence phase of the loan origination process. If completed, it is intended that the responses be posted to the relevant public side data room for review by prospective lenders. In developing the Questionnaire, the LSTA was mindful of three main considerations: 1) it should be applicable to any borrower in any industry; 2) recognising that many companies are just beginning to conduct an "ESG review" of their businesses, a borrower should be encouraged to share any early concepts that it has identified; and 3) this initial version should be manageable in scope as this is a nascent diligence request. The LSTA hopes the Questionnaire offers borrowers a streamlined method to communicate their ESG story to their lenders and makes clear that ESG is being taken seriously in the loan market. This is certainly an area we expect to evolve with time.

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 intense focus on the phase-out of LIBOR and increasing interest in sustainable finance and ESG. 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 and through work with LSTA membership. 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 and supporting guidance, where appropriate, as well as educate loan market participants on sustainable lending. The LSTA will also monitor the use of the ESG Questionnaire in loan transactions and looks forward to seeing that initiative evolve—just as the ESG itself continues to evolve.

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., at 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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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.

www.lsta.org

LSTA
CELEBRATING 25 YEARS

Loan Market Association – An Overview

Nigel Houghton

Loan Market Association

Hannah Vanstone

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 LMA'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 743 in 2019, including banks, non-bank institutional investors, law firms, ratings agencies and service providers from 68 jurisdictions.

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 also saw the LMA 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 LMA 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, as well as facility agreements for use in South Africa, Kenya, Tanzania, Uganda and Nigeria.

In early 2014, the LMA 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, the LMA expanded its 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.

In 2019, the LMA's documentation projects included the production of an exposure draft of a reference rate selection agreement for transition of legacy transactions to risk-free rates as well as exposure drafts of compounded risk-free rate facility agreements for sterling and US dollars (together the "Exposure Drafts"). In March 2019, the LMA also produced a set of sustainability linked loan principles, which are intended to 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 (the "Sustainability Linked Loan Principles"). In addition, the LMA also updated its EU bail-in legislation schedule.

Looking ahead to 2020, 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.

The UK's departure from the EU will have a major impact on the future financial landscape in the UK and Europe, but 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 full 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). The LMA continues to work hard alongside its members to ensure that the transition to risk-free rates is achieved in the loan market by the end of 2021. The Exposure Drafts were developed in conjunction with preliminary input and views provided by a working party consisting of representatives from a wide range of market participants and advisers (including corporate borrowers and the ACT). The Exposure Drafts do not constitute recommended forms of the LMA; they have been published as exposure drafts which are open for comments from market participants. The intention of the Exposure Drafts is, amongst other things, to facilitate awareness of the issues involved in structuring syndicated loans referencing compounded SONIA, SOFR or other risk-free rates and the development of an approach to these issues by market participants. The LMA also published a revised version of the existing "Replacement of Screen Rate Clause" in 2018, which is now widely used in the loan market.

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, 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 revised to include, among other things, an optional incremental facility.

In 2018, the LMA updated its suite of developing markets facility agreements, its confidentiality and front running letter for primary syndication and its secondary documentation, as part of the ongoing review of its entire documentation suite. In 2019, the LMA updated its guidance note on United States and European sanctions and also updated its EU bail-in legislation schedule. The LMA continues to monitor and update its documentation in response to member comments as well as market and regulatory changes.

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*. 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 recently, in 2019, the LMA published *Closing a Primary Syndication – Factors to Consider*.

Most recent publications include: a recommended timeline for settlement of primary syndication incorporating delayed settlement compensation, as part of its efforts to reduce settlement times for primary syndications; the Green Loan Principles (following closely the core components of ICMA's Green Bond Principles); the Sustainability Linked Loan 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. Three new desktop series guides were added in 2019, covering rollovers, drawdowns and repayments.

The LMA intends to launch additional guidance in relation to the Green Loan Principles and Sustainability Linked Loan Principles during the course of 2020.

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. In relation to the transition to risk-free rates, the LMA has also recently published a number of guidance notes, including a guidance note on €STR publication and changes to EONIA; a note on the LMA Revised Replacement of Screen Rate Clause and considerations in respect of credit adjustment spreads; and a note on recent developments relating to the future of EONIA.

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 LMA'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 €STR-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. The LMA is 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. The LMA 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, the LMA 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. In 2019, the LMA managed to secure HM Treasury approval for the LMA's revisions to Sector 17 of the JMLSG Guidance. The revised Guidance is intended to provide a clear description of the primary and secondary syndicated loan markets, an assessment of where the risks are most likely to arise when considering money laundering and terrorist financing, and to explain the different types of relationships that exist between the parties to a syndicated loan transaction and the instances where this will translate into a direct customer relationship between those parties. In 2020, the LMA hopes that its participation in this area will continue to 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, the LMA will be required to monitor more recent initiatives such as green and sustainable 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 2019, over 1,000 delegates attended the LMA's 12th annual Syndicated Loans Conference in London (with a further 600 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 conferences in East and South Africa. In total, over 25,000 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 14th year and will be run three times in 2020. 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 2020 will run in London and Nairobi. A Real Estate Finance Certificate Course was also launched in 2018, aimed at 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 LMA 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 41 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 2020, the LMA plans to hold over 85 events throughout EMEA, as well as expand its e-learning offering and release further webinars and spotlight interviews. During 2020, the LMA will also be running events in more cities than ever before, including, Accra, Amsterdam, Birmingham, Brussels, Budapest, Cairo, Dubai, Dublin, Edinburgh, Frankfurt, Istanbul, Johannesburg, Kampala, Kiev, Lagos, London, Madrid, Milan, Moscow, Nairobi, Paris, Prague, Stockholm, Tel Aviv, Vienna, Warsaw and Zurich. The LMA will also hold the following conferences throughout 2020: Real Estate Finance (London); Developing Markets (London); Loan Operations (London); East Africa (Nairobi); Sub-Saharan Africa (Johannesburg); Middle East (Dubai); FinTech (London); and its annual Syndicated Loans Conference (London), now in its 13th 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 2019, the LMA held its 5th 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.

During the course of 2019, the LMA have actively engaged in various regulatory initiatives, most notably assisting in drafting the revisions to Chapter 17 of the JMLSG Guidance. In addition, the LMA 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.

The LMA continues to work tirelessly to break down communication barriers in the syndicated loan market as a whole, through the promotion of its escalation matrix and via its education forums, including its 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 2020 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 second 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 around €900bn in 2019.

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 €29.8bn in 2019.

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 2019 suggest that market participants are cautiously optimistic about prospects into 2020, although the results also recognise some of the challenges faced in the global environment. Some 26.2% of respondents expect loan market volumes across EMEA to grow at least 10%, whilst 45.5% predicted relatively unchanged volumes in 2020. Global economic and/or geopolitical risks (including Brexit) were cited as the biggest potential influence on the market in 2020 with 59.2% of respondents, with competitive pressure second at 14.6%. Respondents saw refinancing activity as the main volume driver at 34.3% of the vote, with restructurings at 21.9% and new money requirements in corporate M&A at 16.3%. 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 2020 and beyond. Environmental, social and governance issues are increasingly moving up the agenda for market participants throughout the syndicated loan market. 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. The LMA expects 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.

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The LMA has as its key objective improving liquidity, efficiency and transparency in the primary and secondary syndicated loan markets in 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 LMA's membership has grown steadily and now stands at over 700 organisations covering 68 jurisdictions, comprising commercial and investment banks, institutional investors, law firms, service providers and rating agencies.

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LMA | Loan Market Association

Asia Pacific Loan Market Association – An Overview

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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 the 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 the 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 the 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 the 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. The APLMA has recently launched principles working towards standardisation of project finance loan documentation, an important initiative which has been well received in the market.

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 Loan-related Cross-border Marketing

In January 2020, the APLMA published an Outline on Loan-Related Cross-border Marketing Considerations for certain Asia Pacific jurisdictions. This set out for each jurisdiction, in an executive summary and more detailed outline to be read together, some of the considerations a bank should be aware of before sending a representative into another jurisdiction to market certain loan products of the bank to local corporate customers. The outline covers the following jurisdictions: Australia; the PRC; Hong Kong; Indonesia; Malaysia; the Philippines; Singapore; Taiwan; and Vietnam.

This guide serves as a useful reference and can be found on the APLMA website.

Conferences, Seminars and Knowledge-Sharing Events

In 2019, 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 2019 and attended by more than 450 delegates) and the Annual Conference held in Singapore in May 2019 (500 delegates). Highly successful conferences were also held in Auckland, Ho Chi Minh City, Jakarta, Kuala Lumpur, Melbourne, Manila, Mumbai, Shanghai, Shenzhen, Singapore, Sydney, Tianjin, Taipei and Tokyo.

Of particular note were the two Leveraged Finance conferences held in Hong Kong and Singapore in August and November 2019, 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 region were also well attended. Worthy of mention were the competition law seminars and webinars, in-depth sessions on LIBOR transition and the documentation workshops in Hong Kong and Singapore in English and Putonghua.

The APLMA in China

In line with the Association's drive to reach out to multiple important Chinese cities, the APLMA held its Loan Market Conference in Shanghai in September 2019.

Further (and highly successful) regional conferences took place in Shenzhen in January 2019 and in Tianjin in March 2019.

Sustainable Finance

The APLMA is deeply committed to promoting and advancing green and sustainable lending to its members in the APAC region. In 2019, it organised dedicated conferences on this important topic in Singapore, Australia and New Zealand and invariably provides a platform at its other conferences for education and debate on green and sustainable finance. Both the CEO and Head of Legal have spoken at a number of high-profile conferences including those organised by the Hong Kong Monetary Authority, Environmental Finance and the LMA.

In 2018, the APLMA worked with the LMA and LSTA to produce the Green Loan Principles modelled on the ICMA Green Bond Principles. In April 2019, it again worked with those associations to produce the Sustainability Linked Loan Principles which incentivise borrowers to transition from brown to green activities and are having increased traction and take up in the market. The GLPs and SLLPs aim to create a high-level framework of market standards and guidelines which facilitate a consistent methodology across the wholesale green and sustainability linked loan market. The three associations are further developing two Guidance documents to provide market participants with clarity on the application of the GLPs and SLLPs, and promote a harmonised approach.

Along with a number of leading banks and other financial institutions, the APLMA is represented on an International Standards Organisation Technical Committee on Sustainable Finance as well as the ICMA Working Group on Climate Transition Finance.

LIBOR Transition

The evolution of risk-free benchmark rates and the expected demise of LIBOR cannot have escaped anyone's attention over the last 18 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 recently 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). The 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 Hong Kong, Singapore, Melbourne and Sydney and raised the subject at every APLMA conference held in the APAC region over the last 12 months.

The 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. The APLMA recently published the results of a survey seeking the views of its members on the various structuring issues arising out of the publication of LMA Exposure Drafts which use near risk free rates rather than LIBOR as the primary benchmark. There was an extremely encouraging response and members' views have been communicated to the LMA.

At the time of writing, it is looking increasingly likely that LIBOR will actually disappear at the end of (or even before) 2021 and that some sort of RFR methodology will replace it. However, there is still 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) need to rapidly prepare themselves 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;
- setting up working groups in Indonesia and Malaysia to develop facility agreements for use in those markets (and in the latter case Shariah-compliant);
- 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 and Sustainable Finance as its GLPs and SLLPs continue to shape the market; and
- developing and improving the APLMA's training and knowledge sharing offering and make it more accessible in less developed frontier countries in APAC.

Andrew Ferguson is the Chief Executive Officer and a veteran of the banking industry (with 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.

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Rosamund Barker is a commercially minded finance lawyer and currently Head of Legal at the Asia Pacific Loan Market Association based in Hong Kong. She has spent much of her career working in the Banking and Finance and Capital Markets teams at Linklaters in London and Hong Kong, most recently as Counsel Professional Support Lawyer. She was also Director of Knowledge Management for Asia Pacific at Baker McKenzie. She has been active in raising awareness of the APLMA's Green Loan Principles and Sustainability Linked Loan Principles to Borrowers and Lenders and has spoken at a number of high-profile conferences in the region.

Rosamund read law at Churchill College, Cambridge University and is a qualified solicitor both in Hong Kong and England & Wales.

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The APLMA was founded in August 1998 by 15 major international banks. As at the end of 2019 it had 345 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 Singapore, as well as offshore committees in China, India, Indonesia, Malaysia, New Zealand and Taiwan.

The 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.

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ASIA PACIFIC LOAN MARKET ASSOCIATION
APLMA

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. Notwithstanding recent trends that signal a shift away from globalisation and free trade in certain contexts, 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 (continued) 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 number 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 jurisdiction.

For example, a US lender seeking to enforce a loan agreement against a non-US 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 non-US jurisdiction. In either case, there is reliance on the laws, institutions and legal process in the borrower's home jurisdiction.

If the non-US 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 the Argentine financial crisis, 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 in 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 2019 rankings, each of China, Kazakhstan 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 when 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 typically 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. 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 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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Global Trends in Leveraged Lending


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1 2019 Overview

Global syndicated lending dipped in 2019, compared with its 2018 high, as increasing geo-political uncertainty and trade barriers impacted confidence around the world. According to Refinitiv, 2019 saw US$4.5trn of syndicated lending worldwide in 9,614 loans (representing a 13% drop in total proceeds and 7% decrease in the number of loans compared with 2018). Despite a lacklustre year, activity levels buoyed in Q4, with loans increasing 6% from Q3 numbers, thereby ending 2019 on a more positive note. By region, lending activity in the Americas accounted for 61% of the global market, while syndicated lending in Europe hit a two-year low. Specifically, M&A-related financing fell 23% compared to a year ago, representing the slowest annual period for M&A-related lending since 2014.

Region	Number (change since 2018)	Amount (change since 2018)
Europe	1,492 loans (-4%)	US$891.4bn (-6%)
Americas	4,723 loans (-9%)	US$2.7trn (-16%)
Middle East and Africa	163 loans (-24%)	US$93.6bn (-38%)
Asia-P	1,461 loans (+2%)	US$496.6bn (7%)
Global	9,614 loans (-7%)	US$4.5trn (-13%)

Source: Refinitiv

According to S&P LCD, new issuances of European senior leveraged loans fell 15% in 2019, with 169 deals making up €81bn in volume. The UK and France remained sponsors' countries of choice for European financings. The largest proportion was for acquisition-related purposes, despite a muted M&A market in Europe due to uncertainties caused by Brexit. Despite that, borrowers and financial sponsors took advantage of cheaper financing available to reprice, refinance and fund dividend recapitalisations.

Use of proceeds	Deals in 2019 (change from 2018)	Deals in 2018
Acquisition-related	49.7% (↓)	58.2%
Recap	13.6% (↑)	7.7%
Re	34.9% (↑)	32%
Other	1.85% (↓)	2.3%

Source: S&P LCD

Despite a drop in leveraged loan issuance, European CLO volumes rose to their highest levels yet, to just under €30bn in 2019, representing a 48.7% share of the primary market. This increased demand has driven down pricing in the European leveraged loan market and contributed to an increase in activity in Q419.

In the secondary market, the S&P European Leveraged Loan Index ("ELLI") recorded its 2019 high in September, when the weighted average bid reached 98.62. The ELLI finished the year at 98.28, which was 95bps above its level at the start of the year. At the end of December, the share of loans priced at par or higher reached 51%, up from 38% in July.

In the US, based on data published by LCD News, new issuances of leveraged loans fell 23% in 2019, with 517 deals making up $480.23bn in volume. There were apparent signs of investor appetite for greater creditworthiness during an uncertain year and a tepid M&A market, as the share of issuers rated B+ or lower accounted for about 49% in the US leveraged loan market, down from just under 60% in 2018. Nonetheless, borrowers took advantage of cheaper financing with a high proportion of repricing and recapitalisation transactions than in 2018.

Use of proceeds	Deals in 2019 (% of total)
Acquisition-related (including LBO)	$244.2bn (27.1%)
Recap	$20.0bn (2.2%)
Re	$333.5bn (37.0%)
Other	$304.8bn (33.7%)

Source: Debtwire

Despite a drop in leveraged loan issuance, US CLO volumes rose to $118.7 bn in 2019. In the secondary market, the S&P/LSTA US Leveraged Loan 100 Index recorded its 2019 high in December, when the Index finished the year at 2273.18, which was 215.66 above its level at the start of the year.

Default rates remained low globally through 2019, which can be attributed to a combination of low interest rates and cov-lite terms in loan agreements. The continued erosion of lender protections coupled with aggressively permissive borrower terms (see further below) over the past few years mean that things would have to be incredibly bad (almost terminal) for a borrower to trigger a default under their loans. For now, investors remain positive, although risks remain and default rates seemed to creep up a little in Q419 according to ELLI.

More generally, investor activism and concerns over corporates' environmental, social and governance responsibilities resulted in a rise in the prominence of green and sustainability-linked loans. The Loan Market Association, Asia Pacific Loan Market Association and the Loan Syndications & Trading Association jointly published their Green Loan Principles in December 2018, followed by the Sustainability Linked Loan Principles in March 2019. According to Dealogic figures, EMEA saw an exponential growth in ESG-linked and green loans from US$41.3bn in 2018 to US$112.3bn in 2019 and rising, while in the Americas, green and sustainability-linked loans reached nearly US$16bn in 2019, up over three times compared to 2018 totals, according to Refinitiv.

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 issuances were covenant-lite, according to LCD. The prevalence of covenant-lite has steadily grown year-on-year since 2008, culminating in 88% of syndicated leveraged loans in 2018 having no maintenance covenant at all, and 93% in 2019.

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.

2019 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, approximately 75% of deals in 2019 permitted unlimited asset disposals and 35% of senior financings featured step-downs in the amount of asset sale proceeds being required to prepay loans (up from approximately 25% in 2018);
- 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, by the end of 2019 the number of deals that saw terms flexed once deals were launched reduced, but investor pushback remained in focus on initial terms. Pricing-related flex either on MFN or margin remained the main pressure point. Six-month guaranteed fee periods were pushed back in favour of a nine-month period and two ratchet step downs were favoured by lenders. According to Covenant Review, at the end of 2019 there was particular focus on the incremental debt capacity terms with both inside maturity baskets and 2× fixed charge coverage ratio tests being dropped as well as the freebie basket reducing and ratios tightening.

In the US, by the end of 2019 investors have provided additional push-back on terms especially for less creditworthy borrowers as some investors believe that the end of the current cycle is approaching. Investors have been focused on creditworthiness with the gap between double-B and single-B clearing spreads in the institutional loan market peaking at 233 basis points, up from 67 basis points at the beginning of 2019. Also, certain sectors have shown growing concern and have received more focus and pushback by investors with retail and energy remaining at the forefront and healthcare and technology companies presenting growing concerns due to deteriorating ratings. According to Covenant Review, investors in 2019 did have success in pushing back on terms regarding the flexibility to incur additional debt, divert value away from secured lenders, and prevent lenders from engaging as performance deteriorates. In response to increased investor scrutiny on less creditworthy borrowers, some private equity sponsors have been willing to provide the lead arrangers with long lists of "flex" items which can be sacrificed as needed and will often have an understanding at the outset of the deal that these items are less essential.

4 Incremental Debt – MFN and Maturity Exceptions

According to Xtract Research, in the European TLB market all Q319 SFAs provided for unlimited incremental debt capacity in compliance with a financial ratio test (typically a senior secured or total net leverage test).

The inclusion of an entirely separate basket which enables the group to incur additional debt in addition to that under the financial ratio test (known as the "freebie basket") continues to be commonplace with the majority of SFAs in 2019 including such a basket. Whereas in 2018 these freebie baskets were commonly set at a soft cap of 100% of EBITDA, 2019 saw a steady decline in the number of SFAs with grower freebies soft capped to this level (and was often seen as a flex item).

In addition, it is worth noting that in certain sponsor deals freebie baskets took into account certain add backs, including voluntary prepayments, debt buybacks and many other commitment reductions of the existing senior debt made prior to the date of the incurrence of the relevant incremental facility, to the detriment of its investors.

MFN protection limits the amount by which the effective yield on an incremental facility exceeds the effective yield on the original loan. The yield protection may turn off after a stated period after closing (a "sunset") and sunset periods in 2019 in Europe have dramatically changed as compared to a year ago. In 2018, 100% of deals had a 12-month sunset, whereas in 2019, according to Debt Explained, 50% of deals had sunsets of six months (or more). In addition, 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 in more aggressive deals) the margin; however, in a small number of deals in 2019 some SFAs were tightened to 0.50% and 0.75%.	0.50% cap on all-in-yield is customary, but borrowers have requested 0.75% to the extent the market will accept it; caps higher than 0.50% are less common in middle market deals.
6- to 12-month sunset (ex to remove or extend); however, according to Debt Explained, in a positive turn for investors in Q319, 17% of those deals had no sunset.	6- to 12-month sunsets have become more common than the more lender-friendly 18- and 24-month sunsets seen in prior markets, although 6-month sunsets remain atypical in middle market deals.
Applies to *pari passu* same currency term loans with a similar maturity. More aggressive sponsor deals sometimes see exceptions for incremental terms loans incurred in reliance on the freebie basket or incurred to acquisitions (although these are often removed during syndication).	Applies to *pari passu* same currency term loans. MFN carve-outs exist for debt incurred to permitted acquisitions and/or all portions of a free and clear basket and/or ratio component. Other deals have seen reallocation of general debt basket capacity to incremental debt which is then secured on a *pari passu* basis with the existing loans and allows the holders of this debt the bene- of a *pari passu* intercreditor arrangement (or joining debt incurred under the general basket to an acceptable intercreditor arrangement).
Freebie basket (typically a grower basket soft capped to a % of EBITDA).	Similar (typically a ed dollar or ratio basket as determined by the borrower).
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 ex to modify or remove exclusions): ■ within a threshold (a specified dollar amount or fixed amount of incremental debt); ■ incurred under the freebie basket; ■ which mature after a specified period (one or two years) after the maturity of existing loans; ■ incurred in connection with an acquisition or investment; and ■ *pari passu* secured debt in the form of bonds.

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. According to Covenant Review, while the accordion inside maturity basket has been declining in size, its prevalence across the market is increasing. In Q319, this figure had increased to 26% (compared to 0% in Q119). This figure is now at 45% in US deals.

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 an EBITDA based grower; and ■ incurred under the freebie basket. Inside maturity baskets are often seen as ed terms.	Similar; a basket of incremental loans can mature sooner (or have the same weighted average life to maturity) than the maturity of the then existing term loans than previously allowed. Inside maturity exceptions subject to a dollar cap appeared in about 30% of middle market deals, compared to 70% of large cap deals as of 1H19.

The majority of SFAs now tend to permit the incurrence of debt to fund an acquisition or the group to assume debt as a result of an acquisition. A particular trend of 2019 was that this acquisition or acquired debt was permitted only to the extent the relevant ratio was not worsened as a result of such incurrence. Acquisition-related MFN carve-outs slightly increased in the first three quarters of 2019, increasing slightly from 2018. The trend in investor pushback on MFN carve-outs is mixed.

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, with levels in 2019 initially seeing a steady decline in SFAs with uncapped addbacks back on the rise at the end of 2019 at 26% according to Covenant Review.	Uncapped continue to appear in about ⅔ of large-cap sponsor deals and about ⅓ of middle market sponsor deals. Caps range from 15–35% EBITDA with around 20–25% being the most common cap. In certain instances where a cap is agreed, adjustments of the type found in the sponsor model, quality-of-earning report, and Reg S-X are generally not subject to the cap according to Thomson Reuters.
24-month time horizon to be realisable.	Large cap: 24-month is common for *pro forma* adjustments with stronger borrowers often getting 36 months. Middle market: similar, although sometimes also apply to the realisation of cost savings, compared to the implementation.

Covenant Review notes the beginning of 2019 saw a marked decrease in the number of deals clearing the market with uncapped EBITDA adjustments; however, towards the end of 2019 these numbers began to increase again. Despite the increase in uncapped EBITDA adjustments the large majority of deals still contain a cap on adjustments and this should be considered the market norm.

2019, according to Covenant Review, also saw 12-month look-forward periods for realisation decline in prevalence in the last half of 2019 compared to the first half of the year with 63% of Q319 SFA look-forward periods being set at 18 months. 24-month periods declined to 11% in Q319 SFAs.

6 Ratio Debt

2019 saw an increase in the use of ratio debt capacity in leveraged loans as yet another alternative way for additional debt to be incurred. Ratio capacity in most cases represents the largest amount of available debt capacity allowing a borrower to incur debt provided that a specific ratio or ratios are met:

Ratio Debt
Total leverage ratio and/or a 2:1 ed charge coverage ratio for unsecured debt.
Total secured leverage ratio for junior secured/second lien debt.
Senior lien leverage ratio for senior lien debt.

Xtract Research reported that after an initial decline in SFAs that permit ratio debt by reference to the 2:1 fixed charge coverage ratio in 2019, towards the end of 2019, there was an increase in this number (to around half of SFAs). What was consistent throughout 2019 was that the fixed charge coverage ratio test was seen being subject to flex during syndication where this ratio was seen changing to a total leverage test.

7 RP Capacity

2019 showed that investors continue to focus on restricted payment capacity and is one of the covenants which continues to be subject to pushback during syndication. According to Covenant Review, in the first three quarters of 2019, 60% of deals looked to tighten up restricted payment capacity before launching general syndication and nearly 60% of deals further tightened this capacity during the general syndication period. Generally, European lenders have rejected net first lien tests for RP capacity to become available via an incurrence-based ratio test.

Most deals require between 1× to 2× of deleveraging on a total new leverage basis before "uncapped" RP capacity becomes available, with this amount diminishing steadily throughout the course of 2019.

The ability to utilise any available RP capacity to increase debt capacity was seen in a number of term sheets during 2019 but the ability to do this was removed in the majority of instances at long form documentation stage. To the extent the provision does survive, it is most frequently seen being added to the contribution debt permission increasing the basket by the amount not utilised under the RP capacity and electing instead to use it to incur additional debt. The majority of deals with this feature include a "Permitted Collateral Lien" permission such that any additional debt incurred by the increase in debt capacity can also be secured on a *pari passu* basis with the SFA facilities.

8 Transferability

In 2019, transferability continued to be a key topic with assignment and transfer regimes becoming ever more restrictive for lenders.

European TLB[1]	New York TLB
■ Borrower consent required other than: ■ to existing lenders; ■ to lenders on a whitelist (83% in Q319) or a blacklist (17% in Q319) but not both; and ■ during any EoD (17% in Q319) or payment or bankruptcy EoD (83% in Q319). ■ 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 to 15 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 continued to be a focus during 2019. An increasing number of deals in 2019 contained a restriction on transfers to "competitors" or "industry competitors" with such terms being widely defined and the majority of these restrictions remaining in place following events of default regardless of the nature or materiality of the event. In some sponsor deals, however, the bar was pushed even further with a blanket restriction on transfers with any transfers (other than to affiliates) being subject to written consent.

9 Margin Ratchet

2019 has seen greater consistency in the types of triggers used for the margin ratchet to flip back up to its highest level. According to Debt Explained, 59% of deals in Q319 included a trigger based on payment, insolvency or financial information delivery Events of Default, with a further 20% of such deals including triggers based on a payment or insolvency Event of Default. In the previous three quarters, there was greater diversity of this trigger, including, amongst others: upon an Event of Default; upon any default; upon any Event of Default or financial covenant delivery; upon an Event of Default at the election of the Majority Lenders; and upon a payment of financial covenant Event of Default.

	Q4 2018	Q1 2019	Q2 2019	Q3 2019
Only upon a payment or insolvency EoD	7%	18%	50%	25%
Only upon a payment, insolvency or nancial information/Comp Cert delivery EoD	50%	18%	25%	59%

Additionally, in 2019, pushback against a margin ratchet holiday has continued, with Xtract Research reporting that the most common delays they saw in Q319 were six months or two full financial quarters (collectively 47% of Q319 SFAs). Nine months or three full financial quarters represented 32% of SFAs in Europe with only a small handful allowing a 12-month delay from closing.

10 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. It is now commonplace to permit unlimited asset disposals for fair market value and 75% cash and cash equivalent consideration.

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 545 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 to remove leveraged based step-downs). According to Xtract Research, in Q319 only around a quarter of SFAs had a leverage-based step down to asset sale prepayment requirement (which shows a steady reduction from earlier in 2019).	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.

11 Anti-Net Short Provisions

One notable development in the leveraged loan market in 2019 was the inclusion by financial sponsors of "Anti-Net Short Provisions". A lender will be considered a "net short lender" when its long position in a loan is outweighed by its short position in a credit default swap or other derivative. Such a position leads to net short debt activism whereby net short lenders call defaults under the relevant loan documentation to force a pay-out under a credit default swap or other derivative. Anti-Net Short Provisions are designed to provide financial sponsors with greater control over the composition of their portfolio companies' debt investors and to curtail net short debt activism.

Net short debt activism is not a brand new concept and certain borrowers have been aware of the consequences of working with entities that have net short positions. Well-known examples including Codere's 2013 restructuring and the recent events involving Hovnanian Enterprises. However, in February 2019, Windstream entered into Chapter 11 bankruptcy after a holder of certain of its bonds, who was believed to be a net short lender, alleged that Windstream had breached one of its covenants as a consequence of a transaction that Windstream had undertaken two years prior to the date on which that holder acquired its bonds. Upon seeing the implications of the Windstream case, financial sponsors were quick to introduce Anti-Net Short Provisions in an attempt to protect their portfolio companies from the motivations of net short lenders. Such positions are perceived not to fully align with the interests of the company, equity stakeholders as well as perhaps lenders who hold long positions.

Anti-Net Short Provisions have, to date, primarily been limited to the US leveraged loan market. The general approach in the US is to include provisions designed to provide financial sponsors with greater control over the composition of their portfolio companies' debt investors. For example, provisions implementing disenfranchisement of net short lenders and/or extension of disqualified lender list are included in sections governing amendments and waivers, successors and assigns and/or remedies upon event of default. Representations requiring lenders to disclose their net short provisions to the borrower and the agent are also typically included to give effect to these provisions.

Similar terms are now migrating into the European market and are becoming particularly prevalent in European leveraged loan deals with both dollar and euro tranches. The initial approach to Anti-Net Short Provisions in Europe differed between the leveraged loan and high-yield bond markets. The leveraged loan market typically incorporated provisions disenfranchising net short lenders whereas the high-yield bond market included language which prohibited bondholders from exercising their rights with respect to an event of default that was more than two years old. These contrasting approaches are continuing to evolve and it is now not uncommon in leveraged loans transactions for financial sponsors to propose Anti-Net Short Provisions that comprise a combination of both approaches and also extensions thereof.

The approach to Anti-Net Short Provisions in Europe and the US is still developing and, as such, although they can be seen in an increasing number of term sheets, they are often excluded from the long form documentation.

12 LIBOR

Work in the loan markets to transition away from LIBOR as the reference rate of choice continued apace in 2019. To recap, the UK's Financial Conduct Authority announced in July 2017 that LIBOR will be phased out by the end of 2021, to be replaced by alternative (near) risk-free benchmark rates (RFRs) as follows:

Currency	RFR (transaction basis)	Publication time	Working Group
GBP	SONIA (unsecured)	09:00 GMT T + 1	Working Group on Sterling Risk-Free Reference Rates
USD	SOFR (secured)	08:00 ET T + 1	Alternative Reference Rates Committee

Currency	RFR (transaction basis)	Publication time	Working Group
CHF	SARON (secured)	12:00, 16:00, 18:00 CET	Swiss National Working Group
JPY	TONAR (unsecured)	10:00 JST T + 1	Cross-Industry Committee on Japanese Yen Interest Rate Benchmarks
Euro	€STR (unsecured)	08:00 CET T + 1	Working Group on Euro RFRs

Indeed, regulators regard 2020 as the critical year for LIBOR transition, with growing regulatory and supervisory scrutiny of market participants across jurisdictions. The UK's Working Group on Sterling Risk-Free Reference Rates set out its priorities in a roadmap in January 2020. Key milestones include the cessation of GBP LIBOR-based cash products maturing beyond 2021 by the end of Q320 and to establish a clear framework to transition legacy LIBOR products by Q121.

In the US, the Alternative Reference Rates Committee ("ARRC"), established by the Federal Reserve Board of New York to help coordinate the transition away from LIBOR, has published similar transition plans. The ARRC published final recommendations for fallback language in credit agreements in April 2019, generally specifying two alternative approaches: (1) the "amendment" approach, specifying a protocol for amending agreements to transition away from LIBOR with an unspecified replacement rate; and (2) the "hardwired" approach, with a prescribed replacement rate selected from a waterfall beginning with the Secured Overnight Financing Rate ("SOFR"), a rate which is published by the Federal Reserve Bank of New York based upon secured overnight transactions in the repo market.

SOFR is considered the likely successor to LIBOR in the US, but there are some indications it may not be a representative risk-free rate given the government's heavy involvement in its management. For example, on September 17, 2019, a confluence of events in the repo market caused SOFR to spike by 282 bps in just one day, necessitating robust technical countermeasures by the New York Fed that re-stabilised SOFR shortly after.

Key differences in the derivation and calculation methodologies for LIBOR and RFRs as reference rates will lead to wholesale consequential changes in market operations and documentation. For example:

	LIBOR	RFR
Rate composition	Average of rates quoted by panel banks for a (forward-looking) term.	Weighted average rate of overnight (historic) funding transactions.
Spread adjustments	Incorporates banks' perceived credit and liquidity risks, plus any premium for longer-term funding.	(Nearly) risk-free rate, so lower rate than LIBOR. Need to separately factor in spread adjustments/valuation methodologies.
Rate-setting mechanics in typical loan agreement	Established Screen Rate published at same time for all currencies.	Screen Rate available for RFR. Need to establish new market convention regarding accruals over time, which may be simple or compound interest. Need for new Screen Rate for compounded average RFR to be published by market information provider.
Cash management and notice of payment	Fixed in advance at start of interest period for term; borrowers know at the start of any interest period what they need to pay at the end of that interest period.	Rate calculated daily in arrears; borrowers are what interest they need to pay on the last day of the interest period. Need to establish new market convention to give borrowers notice of the interest due before end of the interest period.
Common fallbacks	Screen Rate for LIBOR → interpolated Screen Rate (plus shortened interest period?) → historic Screen Rate for fallback interest period → Reference Bank Rate → cost of funds.	Screen Rate for compounded RFR → calculate fallback using daily RFR → central bank rate → cost of funds.

Challenges for market participants will, therefore, range from operational (e.g. banking and cash management systems) to markets across product lines (e.g. loans and any related hedging) and contractual (e.g. when to switch to RFRs, documentary fallbacks, resolving legacy deals). The challenges are not just for financial institutions making loans, but also for borrowers. Much work needs to be done to establish new market infrastructures, embed new market protocols and develop operational systems to allow RFRs to replace LIBOR: alignment and coordination between industry participants across jurisdictions and product lines will be crucial.

While forward-looking term RFRs would be the closest proxy to LIBOR in the loan markets from an operational perspective and are actively being developed in some jurisdictions, the timeline for their development is uncertain. In the meantime, the LMA and LSTA have both published "exposure" or "concept" drafts of facility agreements using RFRs compounded in arrears to kickstart discussion in the loan markets around infrastructure, conventions, structuring issues and mechanics necessary for this new loan product. One possible solution to enable borrowers to have earlier notice of the interest payable for an interest period is to use a "lag" mechanism, whereby an observation period equal in length to the interest period, but which starts and ends a certain number of days before the interest period, is used to calculate the interest payable.

New deals: Several financial institutions piloted bilateral facilities referencing RFRs with certain corporate borrowers in 2019. However, at the time of writing, market infrastructure for RFRs is not yet sufficiently mature to transition wholesale away from

LIBOR. A revolving credit facility for Royal Dutch Shell PLC in December 2019 has been the only syndicated loan to hardwire compounded SOFR as a fallback to LIBOR at a later date. In addition, there have been reports of some CLO managers hard-wiring SOFR as a fallback with regards to CLO liabilities.

Legacy deals: Most financial institutions have undertaken an audit of their exposures to LIBOR loans. There is no protocol system for incorporating amendments to finance documentation referencing LIBOR on existing deals (such as that operated by ISDA) so loans will need to be amended on a case-by-case basis, once market conventions and mechanics for RFRs have been ironed out. To date, it has been common for the European and US loan market 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 (usually based on the LMA's "Replacement of Screen Rate Clause" in Europe and the ARCC "amendment" approach in the US, with borrower consent over the replacement rate being a point of negotiation only for top sponsors). In the US, most financial institutions have developed their own institutional views on amendments to incorporate such mechanics concurrent with repricing and refinancing transactions. The LMA has also published an exposure draft of a reference rate selection agreement for use in legacy transactions to streamline the amendment processes in transitioning to alternative reference rates.

13 Security

In 2019, 90% of SFAs saw the guarantor coverage requirement set at 80% of EBITDA; however, it should be noted that this test looks at an increasingly narrow portion of the group. Increasingly, the security and guarantee packages are limited to Security Jurisdictions or alternatively exclude any Excluded Jurisdictions. In previous years, this has been limited to a small number of jurisdictions but over the course of the last year or so these carve-outs have become more extensive. Security Jurisdictions tend to be tied to the material jurisdictions where a group operates at the time a financing takes place but even then sponsors are pushing the barriers often excluding any jurisdiction they deem it difficult (or costly) to take security in.

Additionally, we continue to see the security package diminish and it is now commonplace to see security limited to shares in Obligors, material bank accounts of the Obligors and material intra-group receivables owing to Obligors. In the case of US or English entities, "all asset" or floating security is often required but we have seen some aggressive deals that have English Obligors that do not require any more than fixed share, bank account and/or receivable security. It will be interesting to see over the course of the next 12 months how this trend will develop or whether it will begin to receive greater investor scrutiny during syndication.

14 Direct Lending

Like in the wider leveraged lending market, the effects of geo-political uncertainty and trade barriers had impacted the direct lending space in Europe in 2019. In the 12 months to the end of the second quarter of 2019, the Deloitte Alternative Deal Tracker has reported a 3% decrease in direct lending deals in Europe as compared to the previous year. However, this decrease is likely to be a reflection of the drop in M&A activities in Europe rather than any reduction in appetite for funding from direct lenders.

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 2019. 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.

While the number of direct lending deals recorded have decreased, the size and profile of such deals have moved in the opposite direction. Increasingly, we see direct lenders break out of the small to mid-cap market and push through into the large cap space. In Europe, Acuris reported that there were 11 large cap deals valued collectively at €1.75bn in the first quarter of 2019 compared with just four in the previous quarter and five in the same quarter in 2018 and in the US, Refinitiv reported that there were seven deals of at least $1.0bn in 2019 and the opening months of 2020. Ares Management, for example, refinanced UK telecom services company Daisy Group in a €1bn deal. Direct lenders have also participated in high-profile public-to-private transactions in 2019 such as AlbaCore Capital's financing of TDR's acquisition of BCA Marketplace plc and GSO Capital Partner/Blackstone's financing of Advent's buyout of Cobham plc.

An outcome of the rapid growth of direct lenders has increased competition on loan terms (including leverage) and it has brought a renewed focus on the economics/yield for traditional lead arrangers (for example, if a direct lender takes out the syndicated second lien, what are the risk/returns for doing the first lien term loan with the burden of holding the allocated revolving credit facility).

Private equity sponsors are increasingly attracted by the benefits of having direct lenders participate in the capital structures of their bid vehicles alongside more traditional sources of funding. Direct lenders can help turbo boost sponsors' thirst for leverage by providing second lien financing or financing at the holding company level through PIK holdco loans or bonds or through hybrid instruments such as preferred equity. Direct lenders can also provide larger delayed-draw term loans in order to more efficiently fund future acquisitions. Further, direct lenders will often have special relationships with certain sponsors that are bespoke and give soft comfort to private equity sponsors that they will be there during hard times. Another developing trend is to have direct lenders participate in pre-placed tranches alongside syndicated facilities arranged by investment banks at the commitment paper stage – this can help sponsors ameliorate some of the flex risk they face in syndication, especially in jumbo-sized deals.

15 Increasing Defaults by and Distressed Loans to Chinese Borrowers

Analysts are taking note of signs of distress in China's fast-growing bond market as two fresh defaults towards the end of 2019 unsettled investors counting on state-led bailouts. China's corporate bond market reached RMB 24.6trn ($3.6trn) at the end of 2019, from less than RMB 3trn ten years ago in 2009. Historically, vulture funds have depended on government bailouts which have driven up yield on Chinese bonds, by buying bonds that are already in default due to the assumed government backstop and providing yields over 9% for corporate bonds. However, as of mid-December, defaults on Chinese bonds hit a new record of RMB 160bn ($23bn), a new record after 2018's RMB 120bn defaults, a drastic increase from 2016 and 2017 where defaults hovered around RMB 25bn. The most recent examples of high-profile defaults are the $284m missed bond payment by the Peking University Founder Group and the $1.25bn unpaid foreign debt by Tewoo Group and were particularly unnerving to investors as the former's largest shareholder is Peking University, one of the country's most prestigious academic institutions, and the latter is a major commodities trading firm controlled by the city of Tianjin. The Chinese government has seemed to be increasingly comfortable with letting issuers default, even those with assumed government backing.

The increasing level of corporate defaults in China coincided with the initiation of President Xi Jinping's de-leveraging campaign in 2016, which involved crackdowns on the country's shadow banking industry and introduction of tighter asset management rules. China's major banks drive the country's shadow banking industry (estimated at $8.4trn in September 2019 and involving banks, companies, households, and private individuals) by offering financial products that sidestep regulatory controls on lending. Government crackdown on these opaque products makes it difficult for borrowers to seek new cash or refinance existing debt and coupled with Beijing's willingness to let borrowers default forces financial market participants to take borrowers' creditworthiness more seriously than previously thought. Nevertheless, the bankruptcy system in China, instituted in 2007 with the new Chinese bankruptcy law, is still in its infancy and seldom tested for bond defaults. The government's heavy involvement in the restructuring process casts additional uncertainty for foreign lenders.

Endnote

1. Figures reported by Debt Explained.

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The Continuing Evolution of the Direct Lending Market


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The direct lending, or private credit, market has evolved dramatically over the past few years. While historically focused on middle-market borrowers with financing needs in amounts and with structures generally not available in the broadly syndicated leveraged term loan (or BSL) market, direct lenders have increasingly moved "up market" and now offer private equity sponsors and large corporate borrowers leveraged facilities that compete with syndicated loan financings in facility size, structure and terms. Private equity sponsors and borrowers increasingly compare and contrast the financing options available in the two markets in determining the most efficient option to finance leveraged buyouts and other acquisitions. This chapter discusses the distinguishing characteristics of direct loans that have allowed direct lenders to play an increasingly important role in the large cap loan market as well as certain challenges to the ability of direct lenders to provide answers for all of the financing needs of borrowers.

Characteristics of Direct Lending

Unique structure

The direct lender's fundamental model differs from that of BSL arrangers in the expectation that the direct lender will commit to, make and expect to hold through maturity, the loans with no (or only limited) expectation of syndicating to participating institutional investors. The ultimate lenders in a direct lending transaction will typically comprise the committing lender (and one or more of its affiliates) and, in appropriate circumstances (typically, with an unusually large loan), a small "club" of similarly situated private credit lenders, rather than the dozens or even hundreds of institutional investors that may hold a BSL.

Because direct loans are not broadly syndicated, their execution and closing timelines are often significantly condensed. In particular, due to the absence of any need for a syndication process prior to closing – which typically entails preparing marketing materials and term sheets, hosting lender meetings and calls, obtaining both public facility and corporate family ratings and providing lenders with a period to review definitive loan documentation – direct lenders are often able to close financings within weeks of providing the related commitment, rather than the minimum one- to three-month period typically required for a BSL. Where an M&A process requires an expedited closing, this ability to forego the marketing process may be a highly attractive option and competitive advantage for the buyer/borrower. In response to this perceived advantage, we have seen an increase in arrangers of syndicated financings willing (often in exchange for an increased fee) to accept an "inside date" instead of a formal marketing period[1] or even fund loans directly at closing with the syndication process commencing only on a post-closing basis.

A second outgrowth of the lack of participating institutional investors in direct loans is that direct lenders are not constrained by the leverage-based expectations of investors in the BSL market: most typically, a first lien facility sized up to 4.0–4.5× leverage; and a second lien facility sized up to 6.5× leverage. For example, direct lenders often provide "stretch" first lien (also referred to as "unitranche"[2]) facilities up to 5.5× (or higher) leverage and are willing to consider lending to borrowers with leverage profiles of 7.0× (or higher). In contrast, arranging investment banks may be reluctant to commit to financings at these levels, whether because of regulatory concerns or uncertainty around the ability to successfully syndicate loans that do not meet customary lender expectations to a broad syndicate of institutional investors. In exchange for permitting initially higher leverage levels, direct lenders will often seek to ensure material deleveraging over time through the use of (i) bespoke financial maintenance covenants,[3] (ii) material amortisation requirements (potentially after a relatively lengthy post-closing "holiday"), and/or (iii) a "payment in kind" (PIK) feature providing that all or a portion of interest accrual shall (or, at the option of the borrower, may) be capitalised for a specified period following closing, all of which would be atypical in BSL transactions.

Under certain circumstances, direct lenders may also have greater flexibility to provide financing to companies with complex or atypical assets or liabilities, organisational structures or historical financial reporting. While direct lenders – willing to commit to and hold the entire financing – may be incentivised to engage in the extensive diligence required to understand, analyse and appropriately price such complexity, arranging investment banks may be challenged to find participating institutional lenders, who typically only hold a small portion of the financing and invest in a large number of loan transactions across the primary and secondary markets, willing to invest the time and effort necessary to analyse the novel issues and resulting novel structuring solutions to address them.

It is important to note, however, that direct lenders are not best suited to execute financing transactions under all structures. In particular, financings in connection with large LBOs and other acquisitions that require a significant high yield bond or post-closing working capital component will require the engagement of a traditional investment bank and registered broker-dealer to act as underwriter of the bonds and syndicate of commercial banks to provide the short-term liquidity needs.

Unique terms

Because of the breadth of the direct lending market (ranging from middle market corporate borrowers to portfolio companies of top-tier private equity fund sponsors) and the increasing number of direct lender participants with different structures and investment strategies, it is difficult to provide broad generalisations regarding direct lending "market terms". Still, it is fair to say that direct lenders, when looking at conventional covenant packages, tend to focus on terms governing additional leverage and preventing "leakage".

Debt incurrence

Direct lenders, consistent with lenders and arrangers in the BSL market, rely on various leverage ratios (calculated as the ratio of specified categories of debt to EBITDA) as the key metric for measuring the leverage profile of a borrower. While the same points of negotiation as to the definitions of debt and EBITDA typically arise in syndicated and direct lending deals, direct loans tend to (i) include all debt (including capital leases and that of foreign subsidiaries) secured by any assets of the borrower and its subsidiaries in the numerator of secured leverage ratios (*versus* limiting such debt to that secured by the collateral package agreed in the loan documents themselves), and (ii) contain more company-specific limitations on the "addbacks" increasing EBITDA. In particular, a direct lender will often cap the EBITDA addbacks relating to run-rate cost savings and other synergies for any period at 20–25% of EBITDA for such period. In contrast, a similar addback in a BSL facility – especially for larger and stronger credits – may be uncapped. A second difference between the markets is that direct loans most typically contain a leverage ratio-based financial *maintenance* covenant applicable to the borrower at all times, in contrast to the "covenant-lite" term loans – that have no such maintenance covenant – that are one of the hallmarks of the BSL market. In part due to the increased competition referred to above, we note a recent trend, especially in large cap and private equity-related transactions, for direct lenders to accept either "covenant loose" (*i.e.*, term loans that benefit from a maintenance covenant, but one that is set with significant cushion to closing date leverage) or even true covenant-lite term loan structures. Both direct and syndicated loans to large cap borrowers generally permit the incurrence of an unlimited amount of debt subject to compliance with various leverage ratios, based on the form of the debt incurred. However, direct loans generally do not permit such incurrence based on compliance with an interest coverage ratio, which is a more permissive test in lower interest rate environments. Similarly, direct loans are less likely than syndicated financings to permit borrowers to incur debt in connection with an acquisition that is, in aggregate, accretive or non-dilutive: *i.e.*, if the applicable leverage ratio after giving effect to such debt and related transaction is "no worse than" such leverage ratio immediately prior to such incurrence.

While direct lenders are particularly sensitive to the terms under which additional debt may be incurred, they are, especially for borrowers with an acquisitive investment thesis, often willing to provide significant committed post-closing incremental financing in the form of delayed draw term loan commitments. While this feature is available in the BSL market, the conditions are typically more restrictive – for example, limited to funding specifically identified acquisitions that are scheduled to close within a relatively short period (typically six to 12 months following the initial funding) – and it is still generally disfavoured by institutional lenders seeking the yield certainty of fully funded investments.

Leakage

When referring to "leakage", direct and syndicated lenders focus on both the initial composition of the borrower and guarantor group and related collateral package as well as the ways in which the integrity of such initial structure may be compromised over time. In looking at the initial guarantor group, direct lenders tend to focus on limiting exclusions and exceptions that might "clear" the market in a BSL facility. For example, recent changes in U.S. tax regulations have made it easier in certain cases to include foreign subsidiaries of a U.S. borrower as guarantors. While the BSL market has generally not insisted on including those entities (even after the change in regulations), many recent direct lending transactions do, where feasible, include foreign subsidiary guarantees, relying on diligence and discussions with the borrower to minimise the risk that such structure will create tax issues for the borrower.

After closing, leakage from the borrower and guarantor group comes in a number of forms, including making investments in (or acquiring) non-guarantor entities, paying dividends to the private equity sponsor or other shareholders and prepaying or repurchasing junior debt (collectively referred to, consistent with the nomenclature of high yield bonds, as restricted payments). While the focus on basket sizes, ratio levels and guarantee release mechanics is consistent across markets, direct lenders tend to insist on tighter conditionality around restricted payments, including more robust default "blockers" and protective leverage ratio governors.

This difference in terms is also, in part, a function of the varying processes by which the lenders commit to, syndicate (in the case of arranging investment banks) and make the loans. In particular, the "indicative" committed terms of BSL are subject to "market flex" rights, which permit the arrangers to increase pricing, reduce basket sizes and leverage ratios and make other lender-favourable changes to ensure or promote successful syndication. As such, arranging investment banks are often willing to market more borrower-favourable terms, so long as they maintain the contractual right – via the market flex provisions – to unilaterally revert to more conservative formulations where required by the lender syndicate. With a combination of the right conditions – a strong credit, top-tier private equity sponsor and/or frothy market – participating syndicated lenders may be willing to accept more borrower-friendly terms, which then become precedent for subsequent transactions. In contrast, direct lending commitments are rarely subject to any such flex rights (and, where included, are very narrowly tailored in scope). While this structure provides borrowers with certainty as to the final terms of the loan documentation, it also requires that direct lenders exercise greater discipline in negotiating the terms of the commitment, rather than subjecting them to a subsequent "market" test.

Select Challenges of Direct Lending

Commercial banking affiliates of arranging investment banks have deep experience in the operational and administrative aspects of the various agency roles in a BSL financing. Direct lenders, in contrast, are much more recent entrants to this space and a primary challenge of direct lending is ensuring that borrowers are comfortable with direct lenders' ability to execute these traditional roles after making a direct loan.

One of the most basic functions of an administrative agent in a syndicated loan agreement is to exercise the unilateral discretion granted to it to extend certain delivery and notice periods and approve other matters on behalf of the syndicate.

Providing this level of discretion may be inappropriate in a clubbed direct loan, as each of the lenders, holding a substantial portion of the facility, may expect a voice in such matters. Rather than relying exclusively on the administrative agent, direct lenders will frequently insist that such items are subject to majority lender approval (which, in clubbed deals, with only a few lenders, may include a minimum number of unaffiliated lenders). Borrowers may be concerned that the requirement to obtain approvals for such "regular way" amendments, waivers and consents from multiple direct lenders (rather than just the administrative agent) is overly burdensome. In practice, however, the approval process in direct loans may not differ that dramatically, as (i) straightforward approvals should be routinely and promptly granted by the lenders, and (ii) with respect to any (even potentially) controversial amendment, administrative agents in BSL facilities most typically consult with the lender syndicate and, absent a consensus view, seek approval from the requisite lenders.

A second challenge for direct lenders is a borrower's desire for flexible and readily accessible revolving credit and letters of credit. This ability has long been a mainstay and competitive strength of commercial banks, and while many direct lenders have made strides in providing this critical function, it still represents a challenge to their ability to compete in this part of the financing market. In particular, direct lenders historically – and, in certain cases, still – fund borrowings by calling capital from their investors and/or borrowing under fund-level credit facilities. The time it takes for lenders to do so, however, may be inconsistent with a borrower's desire for funding on short notice. More recently, direct lenders have attempted to mitigate this disadvantage by restructuring their balance sheets to ensure that cash is available in order to make revolving loans on short notice and finding creative ways to issue letters of credit, either directly or through an arrangement with an acceptable third-party provider.

Conclusion

On account of its size, liquidity and, as noted above, potential to offer borrowers greater flexibility on terms, the BSL market will continue to remain a "first call" for private equity sponsors and large corporate borrowers on a wide range of financing transactions. In addition, commercial and investment banks will remain critical providers of cash management, working capital, hedging, underwriting and advisory services. That said, direct lenders are increasingly challenging the BSL model in ever larger and more complex financings. The combination of the direct lender's ability to provide larger facilities, willingness to consider atypical or complex corporate and financing structures and speed of execution has made direct lending an attractive option for borrowers in a range of financing transactions. As a result, they are increasingly competing directly with arranging investment banks to lead large financings transactions for top-tier private equity sponsors and corporate borrowers. As this competition continues to increase, it is certainly plausible that direct lenders will be pushed to accept certain of the more flexible terms included in BSL financings, while arranging investment banks are, in turn, increasingly asked, where required by the dynamics of the acquisition or other underlying transaction, to forego a conventional marketing process as a condition to funding.

Endnotes

1. More specifically, direct lenders and arranging investment banks may provide financing commitments on the basis that the closing date not occur prior to a specified "inside date" (typically not less than 30–45 days following signing of the acquisition agreement) – rather than only following the expiration of a customary 15–20 day marketing period – which is perceived to provide buyers with a competitive advantage in the M&A process by giving certainty of closing timing to sellers.
2. Historically, "unitranche" facilities were a middle-market financing product structured as a single class of loans (from the perspective of the borrower) that were bifurcated into a senior loan tranche and junior loan tranche pursuant to an "agreement among lenders" governing, solely as between the lenders (and completely invisible to the borrower), the respective priorities and rights of the tranches. While such financings continue to exist, the term has become synonymous in the large cap direct lending market with "stretch" first lien loans, not subject to any tranching or intercreditor arrangements.
3. An example of this may be a leverage ratio-based maintenance covenant subject to a six-month to one-year "holiday" during which the covenant is not tested. Once testing commences, the maximum testing level may be subject to material "step-downs" over time.

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Uncertainty Surrounding the Novel Coronavirus Outbreak

In the early stages of the novel coronavirus ("**COVID-19**") outbreak, there is a substantial measure of uncertainty, with economic authorities projecting reduced output and demand from economic dislocation resulting from inhibitions on the movement of people, goods and services, and containment measures such as factory closures. The OECD has released an Interim Outlook[1] in which a best-case scenario is one in which the extent of the coronavirus is broadly contained. But even in the best-case scenario of limited outbreaks in countries outside China, a sharp slowdown in world growth is expected in the first half of 2020 as supply chains and commodities are hit, tourism drops and confidence falters. Global economic growth is seen falling to 2.4% for the whole year, compared to an already weak 2.9% in 2019. But broader contagion across the wider Asia-Pacific region and advanced economies could reduce global growth to as low as 1.5% this year, halving earlier projections.

While equities are well down across global markets, fears of a serious credit event have severely affected credit markets, prompting substantial outflows in the high-yield and loan fund sectors, as well as stalling new issuances. The market is reacting to the concern that the sudden shock to economic activity caused by the virus, including disruptions in supply chains and customer demand, will lead to a substantial decline in credit performance, including increased defaults.

Read against a background characterized by high participation in highly leveraged markets by comparatively passive managers and teetering investor confidence, further sell-downs of credit exposures seem likely. Notwithstanding relatively thin covenant structures, we may see increased interventions with respect to poorly performing credits by aggressive value investors, and growing activity in the workout and insolvency spaces.

Policymakers perceive this and other challenges to the broader markets. On February 28, 2020, Federal Reserve Chair Jerome Powell, noting "evolving risks to economic activity," observed that the Federal Reserve System[2] is "closely monitoring developments and their implications for the economic outlook" and pledged that the Federal Reserve System would use its "tools and act as appropriate to support the economy."[3] Although with a balance sheet still somewhat bloated from Quantitative Easing in the aftermath of the financial crisis and managing increased demand for deposits with Federal Reserve Banks ("**reserves**"), the range of tools available to the Federal Reserve System to address these risks remains somewhat more limited than it may have been in the past. But the Federal Reserve System is not completely impotent, and on March 3, 2020, it announced that while:

> *the fundamentals of the U.S. economy remain strong, … the coronavirus poses evolving risks to economic activity. In light of these risks and in support of achieving its maximum employment and price stability goals, the Federal Open Market Committee [("**FOMC**")] decided today to lower the target range for the federal funds rate by 1/2 percentage point, to 1 to 1-1/4 percent. The Committee is closely monitoring developments and their implications for the economic outlook and will use its tools and act as appropriate to support the economy.*[4]

As discussed below, the Bank Policy Institute ("**BPI**") has suggested to the Federal Reserve System a range of policies that, in its view, would aid in addressing such risks.[5]

On March 2, 2020, the IMF and the World Bank, in a joint statement warning of the "human tragedy and economic challenge posed by the COVID-19 virus," confirmed that they:

> *will use our available instruments to the fullest extent possible, including emergency financing, policy advice, and technical assistance. In particular, we have rapid financing facilities that, collectively, can help countries respond to a wide range of needs.*[6]

The Risks Faced by the Leveraged Lending Market in the United States in the Event of Severe Distress

Three key federal agencies share supervisory responsibility with respect to the banking sector: the FRB, the Office of the Comptroller of the Currency (the "**OCC**")[7] and the Federal Deposit Insurance Corporation (the "**FDIC**,"[8] and together with the FRB and the OCC, the "**Agencies**"). As part of their supervisory function, the Agencies examine U.S. banking organizations.

As part of their examination program, the Agencies annually publish the Shared National Credit report, reflecting an inter-agency review and assessment of risk in the largest and most complex credits shared by multiple regulated financial institutions. In their most recent report,[9] the Agencies observed that "[c]redit risk associated with leveraged lending remains elevated."[10] The Agencies further noted that "[a] significant portion of special mention[11] and classified[12] commitments are concentrated in transactions that agent banks identified and reported as leveraged loans" and that "there has been accumulation of risk in bank-identified leveraged loan structures through the long period of economic expansion."[13] The SNC 2019 Review repeated its finding from the previous year that "many leveraged loan transactions possess weak structures."[14]

The SNC review examined a broad range of bank credits in an aggregate amount of nearly $4.5 trillion. The tested loans are described in Exhibit 1.[15]

Exhibit 1

Overall SNC Commitment Amounts 2018 commitments ($ billion)	2019 commitments ($ billion)	Changes from 2019 *vs*. 2018 ($ billion)	Changes from 2019 *vs*. 2018 (%)	
SNC total commitments	$4,434.5	$4,830.4	$395.9	8.9%
SNC total outstanding	$2,106.0	$2,358.8	$252.8	12.0%
SNC total borrowers	$5,314	$5,474	$160	3.0%
SM and classified commitments	$294.9	$335.4	$40.5	13.7%
SM commitments	$112.4	$131.2	$18.8	16.7%
Classified commitments	$182.5	$204.1	$21.7	11.9%
Non-accrual[16] commitments	$35.8	$39.3	$3.5	9.8%

The sample of bank-identified leveraged borrowers covered by the SNC review constituted 31.2% of leveraged borrowers and 36.0% of leveraged lending commitments. Based on the sample reviewed, the Agencies stated that bank-identified leveraged loan commitments represent 49%, or approximately $2.3 trillion of total the SNC commitments, while 83% of special mention commitments (approximately $93 billion) and 80% of classified commitments (approximately $146 billion) constituted bank-identified leveraged loan commitments.

In addition to identifying significant credit weakness, the SNC reinforced its conclusion from prior years that many leveraged loan transactions possess weak structures, featuring layered underwriting risks and including some combination of high leverage, aggressive repayment assumptions, weakened covenants, or permissive borrowing terms that allow borrowers to draw on incremental facilities and further increase debt levels. While the SNC review includes many seasoned loans, there is evidence that covenants continue to weaken. Moody's Investors Service research supports the contention that that the covenant quality of North American leveraged loans is close to its all-time worst. Moody's Loan Covenant Quality Indicator ("**LCQI**")[17] ended the month of January 2020 at 4.02,[18] a marked decline from its second quarter level of 3.88.[19] The FRB has also noted a decline in covenant quality, stating in mid-2019 that:

> *Credit standards for new leveraged loans appear to have deteriorated further over the past six months. The share of newly issued large loans to corporations with high leverage—defined as those with a ratio of debt-to-EBITDA (earnings before interest, taxes, depreciation, and amortization) above 6—increased in the second half of [2018] and the first quarter of [2019] and now exceeds previous peak levels observed in 2007 and 2014, when underwriting quality was poor….*[20]

By delaying default, weak covenants inhibit lender efforts to intervene earlier to try to remediate troubled credits. In a speech before the Loan Syndications and Trading Association in October 2018,[21] Todd Vermilyea, Senior Associate Director at the FRB, described some of the tactics available to borrowers with weak covenant leverage loans, specifically around risk layering through combinations of incrementals, EBITDA addbacks,[22] and collateral stripping.

"Incrementals" refers to the ability of a borrower to add further debt onto an existing loan to the disadvantage of existing creditors, and without their consent. "EBITDA add-backs" refers to the inflation of EBITDA (earnings before interest, tax, depreciation and amortization), a measure of the cash flow potentially available for debt service, by adding back expenses and cost savings. Finally, "collateral stripping" refers to the practice in which a borrower strips assets away from the first-lien creditors who thought they had rights to those assets as collateral. This tactic has been used in the J. Crew, PetSmart, and Neiman Marcus credits. Such structural features exacerbate the Agencies' belief that a downturn in the economy could result in a significant increase in classified exposures and higher losses.

As noted in the paper Becker & Ivashina, *Covenant-Light Contracts and Creditor Coordination*, "financial covenants are intended to serve as triggers to renegotiation: covenant violations shift control toward creditors,"[23] but fail to serve this function adequately when borrowers are able to implement abusive tactics consistent with covenant structure. But, as strikingly, Becker's & Ivashina's paper suggests that, more than evidencing the influence that borrowers in this market possess over lending relationships, weaker covenants may actually reflect the increasing involvement in the leveraged loan market of comparatively passive investors resembling the holders of public bonds rather than the influence of borrowers over lending relationships. 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."[24] Implicitly, such investors would rather sell the exposure than engage in relatively costly negotiations with borrowers designed to remediate any distress.

The SNC 2019 Review confirms the changing character of market participants, noting that non-bank entities have increased their participation in the leveraged lending market both via purchases of loans or direct underwriting and syndication of exposure. As is set forth in Exhibit 2, from the SNC 2019 Review,[25] banks hold $1.5 trillion or 64% of SNC bank-identified leveraged loans, most of which consists of higher-rated and investment grade-equivalent revolvers. Non-banks primarily hold non-investment grade-equivalent term loans, which are likely to be relatively more sensitive to any economic downturn.

Exhibit 2

SNC Bank-Identified Leveraged Lending Ownership by Credit Type, Quality and Entity Type		
Bank identified leveraged lending	3Q 2019 SNC bank owned ($ billion)	3Q 2019 SNC nonbanks ($ billion)
Investment grade – revolver	$695.0	$14.0
Investment grade – term loan	$210.0	$35.0
Non-investment grade – revolver	$440.0	$23.0
Non-investment grade – term loan	$183.0	$786.0
Total	$1,528.0	$858.0

The inference that weaker covenants are a product of the increased participation of relatively passive investors has an empirical foundation. But the same logic that drew passive investors to low covenant credit products *may* – even without regard to the financial factors that may compel sale – drive them to sell down their exposures rather than face the expensive and time-consuming workout process.

The FRB Financial Stability Report suggests that collateralized loan obligations issuers ("**CLOs**") now fund about 50% of leveraged loans.[26] While not so large a contributor to non-bank holdings of leveraged loans, loan mutual funds purchase about 20% of newly originated leveraged loans.[27]

The FRB Financial Stability Report expresses concerns about the impact of a potential downturn on the largely institutional investors in CLOs, noting that the extent of these losses depends on the conservatism of the CLO structure—specifically, the amount of subordinate tranches and equity. Moreover, the report notes that insufficient market liquidity for CLO tranches could amplify these risks.[28] But, as compared with the investment vehicles associated with subprime mortgages in the financial crisis, CLOs are structured in a way that avoids run risk, and their securities are largely held by investors with relatively stable funding.

In contrast, open-end mutual funds that hold bank loans or high-yield bonds permit investors to redeem their shares daily, and even exchange-traded funds are subject to redemption of creation units, each a challenge when the underlying assets are comparatively illiquid. Such a mismatch suggests that investors may be inclined to redeem early if they fear others are likely to try to do the same. A sizable wave of such redemptions during a stress event could depress bond and loan prices, raising the cost of funds to businesses.[29]

Not only are weaker covenants likely to delay the workout process, but apart from the risks associated with mutual funds noted above, relatively passive investors holding such loans are likely to flee the credit in favor of value investors 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 bail 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, as the share of leveraged loans held by banks declines, it is less clear that the banks will take the lead in working out troubled credits rather than joining passive investors in selling down their exposures.

All of these factors, taken together, reinforce the conclusion that such loans are likely to offers recoveries to traditional institutional investors (including banks) than the historic norms, and that workouts of leveraged loans may be increasingly dominated by aggressive private investors.

Does the Federal Reserve Have the Tools it Needs in Light of its Inability to Normalize its Balance Sheet?

In the event that the COVID-19 (or another exogenous event as yet unimagined) precipitates the crisis that many fear, it is fair to ask whether the Federal Reserve System has the "tools" to support the economy. The financial crisis was marked by a substantial expansion of central bank balance sheets – in the United States and elsewhere – and the ensuing challenge to normalize central bank assets levels and renew the tools necessary to respond to future crises. The size of central bank balance sheets is likely to inhibit the ability of central banks to supply large infusions of liquidity by buying up assets.

Last year, we wrote more specifically about the efforts exerted by the Federal Reserve System to return to normal. These efforts have been marked by legislative limitations on the power of the Federal Reserve System to grant short short-term credit to banks in distress and the reliance by banks on Federal Reserve reserves as a means of meeting their minimum Liquidity Coverage Ratio ("**LCR**") requirement (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 standardized stress test scenario) through holding interest-bearing reserve accounts with their respective Federal Reserve Banks.[30] While assets other than reserves constitute HQLA, reserves have special characteristics when it comes to stress. While it may be difficult to liquidate a large stock of Treasury securities to meet large "day one" outflows, Federal Reserve Bank reserves can be applied immediately to satisfy outflows in a stress scenario.

The growing disinclination of banks to hold Treasury securities as a store for liquidity has had other market impacts, including decreased bank participation in treasury repurchase agreement ("**repo**") markets.[31] Volatility in repo markets in mid-September 2019 threatened to spill over to other markets. In response, the Federal Reserve System has relied on open market operations, primarily repo operations and Treasury bill purchases, and its balance sheet has expanded as a result. Its expanded balance sheets has also supported the maintenance of ample reserves, as was reflected in the Federal Open Market Committee's announcement on October 11, 2019, of its decision to purchase Treasury bills at least into the second quarter of 2020 in order to maintain reserves at or above the level that prevailed in early September.[32] While reserves have already declined appreciably from their peak in 2014, falling by $1.2 trillion to the current, more or less stable, level of around $1.6 trillion, the Federal Reserve System has already effectively retreated from its objective of downsizing its balance sheet in the wake of substantial quantitative easing in response to the financial crisis.

FRB Vice Chairman for Supervision Randal K. Quarles, has described an intention by the Federal Reserve System to stay on the flat portion of the reserve demand curve,[33] with 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.*[34]

In light of the challenges faced by the Federal Reserve System in managing liquidity in markets that are not highly distressed, it is easy to imagine that broad-based market distress would highlight the limits of the Federal Reserve System's influence over markets within the current regulatory framework.

The BPI Solution

The BPI, a nonpartisan public policy, research and advocacy group, representing the nation's leading banks, recognizes the challenge of the COVID-19 virus and the need for bank engagement in working with the Federal Reserve System to continue providing credit to businesses and households and liquidity to financial markets. To that end, it proposed three steps:[35]

1. Monetary Policy

Banks are currently required to maintain about $140 billion of reserves with Federal Reserve Banks in order to satisfy reserve requirements under FRB Regulation D.[36] Reserves required under Regulation D are not included in the HQLA required to satisfy bank LCR requirements. Elimination of required reserves would permit banks to use the resulting liquidity to finance the real economy.

2. Liquidity Provision

The Federal Reserve System permits healthy banks to discount financial assets with the discount windows with Federal Reserve Banks. These collateralized loans are extended at the primary credit rate (the "discount rate"), which is currently 1¾%, 50 basis points above the top of the FOMC target range for the federal funds rate. The BPI notes that banks are reluctant to use the discount window for reputational reasons and discourage from relying on discount window borrowing for more than a few days.

To that end, the BPI proposes that the FRB:

> *First, as it did in the financial crisis, … cut the discount rate to 25 basis points above the top of the target range. By cutting the discount rate, the Fed would be emphasizing that banks were encouraged to use the window should the need arise, reducing the likelihood that banks would respond to any periods of market illiquidity by pulling back from lending to other financial institutions. Second, as was also done in the crisis, the Fed could lengthen the initial maturity of discount window loans to 90 days. Such an extension would provide banks greater confidence that discount window borrowing could be used to address somewhat longer-term funding needs. Perhaps more importantly, it would justify the change to the rollover assumption on discount window loans in the LCR. Third, it could revise its liquidity stress tests and (along with the FDIC) resolution planning requirements to eliminate arbitrary limits on assumed discount window borrowing.*

Finally, the BPI proposes that the FRB use its authority under Section 13(3) of the Federal Reserve Act to extend broad-based discount window privileges to non-banks in "unusual and exigent circumstances," so as to provide liquidity to the market. In particular, the BPI suggests to FRB implement a the Primary Dealer Credit Facility ("**PDCF**") similar to that put in place during the financial crisis:

> [The PDCF] *was essentially a discount window for primary dealers, the large broker-dealers with which are the Fed's counterparties in market transactions. The Fed could prepare the PDCF without announcing or opening it. The approval of the Treasury Secretary would be required before the facility was activated.*

3. Regulatory Policies

Finally, the BPI suggests relaxation or modification of existing or proposed liquidity and capital rules that would enhance the ability of banks to provide credit and to accommodate deposit inflows in the event of a flight to safety.

Endnotes

1. http://www.oecd.org/newsroom/global-economy-faces-gravest-threat-since-the-crisis-as-coronavirus-spreads.htm.
2. The Federal Reserve System is the central bank of the United States and comprises the Board of Governors of the Federal Reserve System ("**FRB**"), which governs the Federal Reserve System, and the 12 regional Federal Reserve Banks, through which the Federal Reserve System engages in its banking and open market operations. The FRB 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 organizations that are treated as bank holding companies as a result of having a U.S. branch, agency or commercial lending subsidiary.
3. Statement of Federal Reserve Chair Jerome H. Powell, avail. at https://www.federalreserve.gov/newsevents/pressreleases/other20200228a.htm.
4. Federal Reserve issues FOMC statement (March 3, 2020), avail. at https://www.federalreserve.gov/newsevents/pressreleases/monetary20200303a.htm.
5. https://bpi.com/actions-the-fed-could-take-in-response-to-covid-19/.
6. Joint Statement from Managing Director, IMF and President, World Bank Group (March 2, 2020), https://www.worldbank.org/en/news/statement/2020/03/02/joint-statement-from-managing-director-imf-and-president-world-bank-group.
7. The OCC, an independent division of the Department of the Treasury, has supervisory and regulatory oversight of national banks, which includes many of the nation's largest banks, and federal branches and agencies of foreign banks. All national banks are members of the Federal Reserve System.
8. The FDIC insures the deposits of all FDIC member banks (all U.S. depository institutions) and has supervisory and regulatory oversight with respect to state banks that are not members of the Federal Reserve System.
9. FDIC, FRB, OCC, Shared National Credit Program 1st and 3rd Quarter 2019 Examinations (January 2020) ("**SNC 2019 Review**"), avail. at https://www.occ.treas.gov/publications-and-resources/publications/shared-national-credit-report/files/shared-national-credit-report-2019.html.
10. *Id.*, at 1.
11. "Special mention," as applied to loans or commitments, is a supervisory classification.
    Special mention commitments have potential weaknesses that deserve management's close attention. If left uncorrected, these potential weaknesses could result in further deterioration of the repayment prospects or in the institution's credit position in the future. Special mention commitments are not adversely classified and do not expose institutions to sufficient risk to warrant adverse rating.
    SNC 2019 Review, Appendix A: *Definitions*.
12. "Classified," as applied to loans or commitments, is also a supervisory classification.
    Classified commitments include commitments rated substandard, doubtful, and loss. The agencies' uniform loan classification standards and examination manuals define these risk rating classifications. Loans that are special mention and classified are considered non-pass loans.
    SNC 2019 Review, Appendix A: *Definitions*.
    Substandard commitments are inadequately protected by the current sound worth and paying capacity of the obligor

or of the collateral pledged, if any. Substandard commitments have well-defined weaknesses that jeopardize the liquidation of the debt and present the distinct possibility that the institution will sustain some loss if deficiencies are not corrected.

Doubtful commitments have all the weaknesses of commitments classified substandard with the added characteristic that the weaknesses make collection or liquidation in full, on the basis of available current information, highly questionable and improbable.

Commitments classified as loss are uncollectible and of so little value that their continuance as bankable commitments is not warranted. Amounts classified as loss should be promptly charged off. This classification does not mean that there is no recovery or salvage value, but rather that it is not practical or desirable to defer writing off these commitments, even though some value may be recovered in the future.

Id.

13. SNC 2019 Review, at 1.
14. *Id.*
15. SNC 2019 Review, Exhibit 2 at 3.
16. Nonaccrual loans are defined for regulatory reporting purposes as loans and lease financing receivables that are required to be reported on a nonaccrual basis because (a) they are maintained on a cash basis owing to a deterioration in the financial position of the borrower, (b) payment in full of interest or principal is not expected, or (c) principal or interest has been in default for 90 days or longer, unless the obligation is both well secured and in the process of collection. SNC 2019 Report, Appendix 1, *Definitions*.
17. The LCQI 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. Loan covenant quality is measured on a five-point scale, with 1.0 denoting the strongest investor protections and 5.0, the weakest. It is, admittedly, a somewhat challenging basis for assessing a broad market, because a decline in lending to the very worst leverage credit borrowers could, while resulting in an improvement of the overall credit quality of originations, result in an increase in the LCQI because the relatively stronger credits are able to negotiate comparatively weaker covenants.
18. Research Announcement: Moody's – Loan covenant protections further weaken (January 23, 2020), avail. at https://www.moodys.com/research/Moodys-Loan-covenant-protections-further-weaken--PBC_1211738.
19. Research Announcement: Moody's – Loan covenant quality levels off in Q2 following early signs of improvement (October 29, 2019), avail. at https://www.moodys.com/research/Moodys-Loan-covenant-quality-levels-off-in-Q2-following-early--PBC_1201188.
20. FRB, Financial Stability Report at 19-20 (May 2019), avail. at https://www.federalreserve.gov/publications/2019-may-financial-stability-report-purpose.htm.
21. https://cdn.ymaws.com/www.iib.org/resource/resmgr/weekly_bulletin/10-24fedspeech_leveraged_len.pdf.
22. In an extended review of EBITDA add-backs, a S&P Global Rating Comment concluded:

    EBITDA add-backs continue to be substantial and overstated, and in fact have expanded as the current prolonged credit cycle extends, with a large portion of total add-backs weighted toward 'B' rated issuers. Aggressive EBITDA adjustments have understated high leverage and purchase price multiples…. [A]dd-backs also present incremental credit risk in the form of future event risk since covenants that rely on EBITDA may provide additional flexibility under negative covenants and restricted payments (e.g. dividends, debt, and lien allowances). When the credit cycle turns, it will be interesting to observe the default and recovery performance of entities with substantial EBITDA add-backs….

    S&P Global Ratings Comment, When The Cycle Turns: The Continued Attack Of The EBITDA Add-Back (September 19, 2019), avail. at https://www.spglobal.com/ratings/en/research/articles/190919-when-the-cycle-turns-the-continued-attack-of-the-ebitda-add-back-11156255.
23. 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.
24. *Id.*, at 4. The authors' 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)."
25. SNC 2019 Review, Exhibit 5 at 5.
26. FRB Financial Stability Report, at 32.
27. *Id.*, at 38.
28. *Id.*, at 25.
29. *Id.*
30. The Federal Reserve lowered the interest rate paid on required and excess reserve balances to 2.10% in July, 1.80% in September, and 1.55% in October, 2019.
31. Banks would presumably be even less inclined to provide more general liquidity to the market, particularly if they already face some degree of balance sheet distress as a result of the holdings of leveraged loans.
32. https://www.federalreserve.gov/newsevents/pressreleases/monetary20191011a.htm.
33. 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.
34. *Id.*
35. https://bpi.com/actions-the-fed-could-take-in-response-to-covid-19.
36. 12 C.F.R. Part 204.

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Acquisition Financing in the United States: Continuing as is in 2020?

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Global M&A and corporate lending showed strength by year end, but 2019 was a bumpy road. M&A deal volume lagged through much of the year, possibly caused by fears of recession, Brexit, political uncertainty, national security and trade wars. Fourth quarter mega deals, however, surged, bringing 2019 global M&A deal volumes to $3.9 trillion, just short of 2018 levels.

2019 deal volumes grew in the United States and Japan, but receded in Europe and other parts of the globe. Healthcare, technology and energy were active sectors with high deal volumes, accounting for over half of the overall volume.

Highlights from 2019 include a $26 billion cash acquisition of TD Ameritrade by Charles Schwab, LVMH's $16 billion acquisition of Tiffany & Co. and Occidental Petroleum's $50 billion acquisition of Anadarko Petroleum. These and other mega deals drove aggregate deal volume up. While the middle market showed strength, middle market deal volume declined in 2019 with a lower number of deals than the past few years.

Acquisition finance showed strength in 2019 and funded both mega and middle market deals. Overall syndicated loan volumes, however, declined from 2018, replaced in part by increased high-yield bond offerings.

A few macro trends in the acquisition finance are worth noting:

First, "buy and hold" direct lenders committed large dollar amounts to larger deals in 2019. While always strong in the middle market, direct lenders made meaningful inroads into the market for larger deals. These lenders offer more flexible terms and structure, and quicker execution, than traditional syndicated lending sources. However, the lack of track record of direct lenders in an economic down-cycle result in unknown questions on their behaviour opposite distressed borrowers.

Second, borrowers pushed back on "debt default activism" (activist investors who buy debt to enforce an existing default as opposed to buying debt based on the credit risk of a borrower). After a few high-profile cases in the US (particularly a case involving activist investors buying debt of Windstream to enforce a default alleged to exist from a transaction the company closed years prior), borrowers pushed to include provisions in credit agreements that will frustrate activist lenders. One such provision is aimed at net-short investors, who hold a large short position on a company's debt while organising lenders to enforce a default under a small long position. These provisions are complex and evolving, and not universally accepted by lenders.

Third, lenders pushed to close loopholes in credit documentation that permitted borrowers to transfers value from the lenders' obligor group by using highly structured transactions. This was particularly seen in unrestricted subsidiary provisions that allow borrowers to designate a subsidiary as not being subject to a credit agreement's covenants. Credit agreements in 2019, particularly for lower-rated borrowers, saw the inclusion provisions intended to limit these transactions.

Indicators suggest that 2020 deal volume and financing will continue at current levels. Much of the worries that drove concern in early 2019, including those mentioned above, lessened over the course of the year, as have worries about a recession in 2020. Private equity and corporate CEOs suggest, in market surveys, a similar expectation.

Similarly, it is anticipated that acquisition financing will continue to be a primary source of funds for acquisitions, particularly in the middle market. 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 have their attorneys draft commitment papers, the larger sponsors are now regularly and successfully insisting that their lawyers prepare the draft 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, not just the best pricing.

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 a precisely worded (and limited) 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 funding risks from a borrower's perspective, 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 for purposes of calculating 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 fail to 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.

"Certain funds" provisions (also commonly known as "SunGard" provisions, in reference to an acquisition financing involving a company named SunGard Data Systems where these clauses were first seen) 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 acquisition loan, as a condition to the lenders' funding obligations, only certain representations and warranties contained in the credit agreement need to be accurate. Strong sponsors even negotiate the precise meaning of the term "accurate" preferring instead that the representations just be "made". 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 continue to be negotiated, but often 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 lower credit quality deals. As U.S. regulators have put more focus on national security, lenders have pushed hard to include stronger representations with regard to these concerns.

Only these limited representations and warranties must be made as conditions precedent to the funding of the loans used to consummate the acquisition. Even if the other representations in the loan agreement could not be truthfully made at the time of the acquisition funding, the lenders nonetheless are contractually obligated to fund those loans. For subsequent, post-acquisition funding of loans under the credit agreement, all representations and warranties would need to be truthfully made.

Company MAC

Company material adverse change (MAC), sometimes referred to as a "company MAC" or a "business MAC", is a type of representation typically included in acquisition 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 contained in an acquisition agreement be used in the related loan agreement, 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 remained strong.

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, risk possibly deteriorating financial markets during the syndication of the commitments and the resulting inability to sell down their 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 selling the loans below par ("original issue discovery" or "oid") or 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 may become broader in scope and give 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. In strong markets, sponsors use 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.

One of the benefits of the direct lender market is that these lenders typically do not require flex provisions because direct lenders often do not intend to syndicate their loans. This can be a significant benefit to sponsors and borrowers seeking certainty of lending terms, particularly on deals that traditional lenders may find challenging to syndicate for structural, economic, market or other reasons.

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 time-consuming nature of lien perfection raises the risk (to the borrower and the seller) that closing may be delayed pending completion of the lien perfection process, 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. Borrowers are permitted to perfect security interests in other asset classes on a post-funding basis. 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.

Sponsors and high credit-quality borrowers have pushed lenders on this further, getting agreements to have even more collateral diligence and perfection steps completed on a post-closing basis.

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 without the lenders' prior consent. 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 typically expect the acquisition agreement to require the seller, pending acquisition closing, 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 operated or restructured in a way that results in its business being less valuable or 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 or other restricted payments 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 still be subject to a breach of contract suit brought by the buyer, but the Xerox provisions should insulate the lenders from suit brought 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 requirements 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 to 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 2020 M&A volumes to remain consistent, while watching for changes in both economic indicators and macro structuring issues with acquisition finance.

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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 chapter, 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.

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 (although this is much less common since the introduction of cov-lite financings in the European market), 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 (other than in some exceptional circumstances). 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.

While recent European second lien intercreditors do not subordinate the junior lien obligations in right of payment to the senior lien obligations, they include payment blockages which achieve the same outcome. Payment blockage periods are 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 (and, in Europe, the underlying debt and guarantee obligations) 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.

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. Fair sale provisions are almost always included, i.e., public auction/sale process, court-administered process or independent fair value opinion. The LMA intercreditor agreement (and most market precedents) 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 junior 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 the junior debt is privately placed or where specialist second lien funds are anchoring the second lien facility including: (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 up 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. Many borrower-friendly U.S. second lien financings now 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 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 entering into 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 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. However, as mentioned in section 4 above, the ability of the senior creditors to credit bid (in most market precedents) is subject to the negotiated "fair value" protections in respect of the junior creditors.

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 governing law of the other loan documents; (4) the likelihood of the borrower group filing for U.S. bankruptcy protection; (5) 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; and (6) the markets where (or investors to which) the syndicated debt is being distributed. 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 intragroup 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 lien agent and the second lien agent and executed or acknowledged by the obligors.	The 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 lien credit agreement.	Security agent takes instructions from creditors holding 66⅔% (or 50.1% where this is wthe applicable threshold in the second lien facility agreement) 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 nancial covenant default (where included) 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 lien facilities on the closing date plus 100% to 120% of the principal amount of any incremental facilities (or equivalent) permitted under the lien credit agreement on the closing date plus secured hedging and other secured obligations.	Rarely included (dictated by the debt and lien covenant in the second lien facility agreement).	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 (in some circumstances).	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.	Sometimes included (above a threshold).	Generally not included.

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

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There are a number of similarities in the general approach taken in relation to drafting and negotiating documentation governing European and U.S. leveraged loan transactions. In 2019, falling interest rates with respect to bank debt and concerns over default rates have caused U.S. investors to look towards equities and fixed-income bonds at the expense of loans. Institutional leveraged loan issuances in the U.S. dropped approximately 29% from 2018.[1] In Europe, leveraged loan issuances also declined, albeit less dramatically than in U.S., dropping 10% by the third quarter of 2019 when compared to the same period in 2018.[2] Notwithstanding a smaller appetite from leveraged loan investors, the supply of leveraged loans in both markets in 2019 generally kept up with demand. Alternative markets continue to develop for borrowers to obtain financing in both the U.S. and Europe, including from hedge funds, private-equity funds and even insurance firms acting as direct lenders.[3] As a result, even though supply has decreased, sponsors continue to reach for aggressive terms and push for covenants that are increasingly borrower-friendly. Recently, however, investors in both the U.S. and European loan markets have pushed-back in certain areas on the expanded boundaries of once standard lender protections, especially through the exercise of "flex" terms. This push-back has been particularly prevalent in the case of non-sponsor-backed deals and lower quality credits.

Despite the various 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 differences between market practice in the U.S. 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 (as is now typical for sponsor-backed deals). Conversely, in the U.S., although the Loan Syndications and Trading Association (the "LSTA") recently published a form loan agreement for investment grade transactions and has published standard forms of certain miscellaneous and operational provisions to be included in agreements governing non-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 agreement is no less favourable to the borrower than such precedent. In the case of sponsor-backed deals, the proposed precedent is usually based on the applicable sponsor's form. 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, both in the U.S. and Europe, sponsor-backed borrowers continue to insist on taking control of, and responsibility for, producing the key documents, and this is becoming increasingly common for corporate borrowers as well. While key economic issues remain within the control of arrangers marketing newly issued loans, particularly through the exercise of "flex" terms, sponsor control over documentation generally 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 (comprises 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 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 United Kingdom's withdrawal from the European Union, the updates to the European "bail-in" legislation, and the impact on the European loan market of the transition away from 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 U.S. (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 between the LSTA and the LMA is that the LSTA forms are rarely used as a starting draft for negotiation, and the LSTA form documentation for U.S. loan agreements is generally used only with respect to certain mechanical and "miscellaneous" provisions of the loan agreements, such as "defaulting lender" provisions, European Union "bail-in" provisions, LIBOR replacement mechanisms, QFC stay terms, 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 that is no longer the case, as the parties almost always identify 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. Notwithstanding this trend, arranger banks remain focused on "flex" terms to mitigate the marketing impact of borrower-friendly provisions in the borrower's preferred documentation.

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. By way of example, rather than providing alternative drafting or commentary in respect of the U.S. QFC Stay Rules, the LMA issued a guidance note in May 2019 which included a link to the corresponding LSTA market advisory (as discussed further below).[4] The LMA note expressly stated that the precedent language contained in the LSTA market advisory should be adapted for inclusion in facility documentation based on the LMA's recommended forms.

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. 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, local lines of credit governed by foreign law and/or letters of credit, but such facilities are beyond the purview of this article. In the U.S. (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 (including obtaining commitments from entities that would be eligible assignees), the consent of existing lenders is not required to increase the overall size of the credit facilities and implement the additional loans and/or commitments.

In the U.S. and in Europe, all lenders (whether revolving credit lenders or term loan lenders) in first lien facilities (other than asset-backed revolving loans, which often share liens on a split-priority basis with the term loans, an arrangement not covered in this article) or unitranche facilities 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 junior 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 (unless, in the case of prepayments, there is basket availability)). 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., certain transactions (typically smaller deals) are structured as a unitranche facility, rather than as separate first lien and second lien facilities, 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 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. The *In re RadioShack Corp.* bankruptcy litigation largely resolved any 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) 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 (and are continuing to demonstrate) their ability to do much larger financings. Despite an overall decrease in European deal volume through the first half of 2019, direct lending activity climbed 107% as compared to the same period in 2018.[5] 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 English courts, cases (such as *Re Apcoa Parking Holdings GmbH & Ors*)[6] 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).

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 U.S. to traditional banking institutions, who typically require a five-year maturity, higher amortisation (which generally starts at 1% per year but increases to 5% or 10% per year during subsequent years) and include at least one, if not multiple, financial covenants, which are tested quarterly. Term B loans, which comprise a large percentage of the more sizeable leveraged loans (especially in the U.S.), are typically held by institutional investors. As a result, term B loans are more likely to be governed by "covenant-lite" agreements, so that there will be only a single leverage covenant with respect to which only the revolving credit facility benefits, and such covenant is only tested if revolving credit usage exceeds a certain percentage of the revolving credit commitments – typically 25% to 35%). 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. First lien term B loans typically require amortisation in an annual amount equal to 1% of the original principal amount thereof. To compensate for these more borrower-friendly terms, term B loans usually 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.[7] Beginning with the end of 2018, the trend towards increasingly relaxed terms faced some resistance, when sharp declines in the trading prices of existing leveraged loans began to prompt more investor-friendly terms (in the form of higher spreads and tighter covenants)[8] on a limited supply of new issuances of debt in response to a lower risk appetite for investors. Noteworthy is the fact that this sharp decline occurred notwithstanding the number of performing credits and low default rates. In many cases, lenders pressured high-yield borrowers to tighten leverage covenants and otherwise "flex up" terms (including pricing). Toward the end of 2019, an important distinction developed between the U.S. and European markets, as the U.S. loan market became increasingly focused on fundamental creditworthiness when determining which borrowers can continue to avoid being subject to more traditional lender protections in their credit documentation. More highly rated loans throughout 2019 still contained more aggressive terms and encountered less pressure to "flex up".[9] As a result, the U.S. loan market has become more bifurcated towards the end of 2019, reflecting greater appetite for higher quality credits and greater selectivity for lower-rated issuances.

Whilst historically 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 to participate in the European loan market 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 U.S., 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, a detailed term sheet will be attached to the commitment letter that will outline agreed-upon key terms and other important concepts to be included in the final loan documentation (including a definitive list of what representations, warranties, covenants and events of default will be included and the definition of EBITDA, including "add-backs"). Such detailed term sheets 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 U.S., 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 satisfying collateral requirements and, in some cases, providing guarantees. Usually, closing requirements are limited to filing Uniform Commercial Code financing statements and delivering stock certificates (and related stock powers) of the borrower (if not a public company) and material U.S. restricted subsidiaries (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 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 their subsidiaries and other affiliates 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 from any leverage or interest coverage calculation. 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. Neiman Marcus's 2017 transfer of its MyTheresa brand to a subsidiary beyond creditor reach and PetSmart's 2018 transfer of over a third of its Chewy.com equity to separate entities represent other recent notable examples of collateral leakage. In response to the high-profile clash between J Crew Group and its credit agreement investors, some investors have been particularly focused on including a specific prohibition on transfers of material intellectual property to an unrestricted subsidiary – commonly known as the "J Crew blocker".[10] These examples aside, a recent study sampling more than 120 credit agreements in the U.S. with effective dates ranging from 2017 through the beginning of 2019 found that, even when focused on sectors that were more likely to have high concentration of core assets in intellectual property, only 17% included direct blocking language.[11] Whilst not historically a feature of the European loan market, the use of the "restricted/unrestricted" subsidiary construct is now also seen in the majority 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 of third parties that otherwise constitute 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" for debt (which can take the form of a fixed amount or may also include a "grower" component based on a percentage of total assets or EBITDA), an "incurrence-based" basket, which requires compliance with a given leverage or fixed charge ratio, and a basket for indebtedness incurred, acquired and/or assumed in connection with permitted acquisitions. These other baskets will be sized based on the borrower's business and risk profile and, if applicable, the lead bank's relationship with the sponsor or the borrower, as applicable. Reclassification provisions (allowing the borrower to utilise one debt basket and then, later, reclassify such debt as being incurred under a different debt basket) are also becoming more common in the U.S.; for example, 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. 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. These reallocation provisions have the effect of allowing borrowers to reclassify transactions that were incurred under a fixed, dollar-based basket as having been incurred under an unlimited leveraged-based basket if the borrower de-levers or if its 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). Initially, the incremental facilities were limited to a fixed dollar amount (typically sized at 50% to 100% of closing date EBITDA), 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 lien 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×). Some deals include increased ratio incremental capacity for acquisitions by providing that the borrower may incur incremental debt even if the closing date leverage ratio would be exceeded, so long as *pro forma* leverage does not increase as a result of the acquisition.

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 by adding a "grower" component to the free-and-clear basket that increases as the borrower's EBITDA (or total assets) grows.

Typically, incremental facilities have a most favoured nations ("MFN") 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 MFN 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 that continued through 2019 saw such "sunset" provisions being flexed out of deals). Such sponsor-friendly agreements often incorporate further provisions aimed at eroding MFN protection, such as (i) limiting MFN protection to incremental term loans borrowed using the free-and-clear capacity or incremental term loans that mature within a certain period (usually, 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. The latter 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. Notwithstanding recent investor resistance to the trend of looser terms in U.S. loan agreements, many borrowers continue to benefit from innovative tinkering with the concept of refinancing debt. 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.

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).

However, whilst uncapped, leverage ratio-based incremental debt capacity is a standard feature of many recent large-cap European loan agreements, the number of European agreements featuring a further "freebie" or "free-and-clear" amount is decreasing. Through the first half of 2019, 77% 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), down from 90% in the first half of 2018.[12] Most of these "freebies" remained soft-capped grower baskets, determined by reference to EBITDA, but the prevalence of "freebies" soft-capped to 100% EBITDA has also reduced, from 68% and 60% in 2017 and 2018 respectively, to just over 50% through the first half of 2019. This trend reflects the increased scrutiny of "freebie" baskets by investors in the European market (predominantly driven by push-back during the syndication process), and indicates a notable difference between European and U.S. terms.

As in the case of U.S. loan agreements, European loan agreements with incremental facility provisions will invariably contain MFN protections. Indeed, 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 any incremental debt incurred in a different currency, or any incremental debt incurred in other forms (such as bonds) from MFN protection. Other loan agreements contained a *de minimis* threshold for incremental debt (beneath which no MFN protection is afforded to the lenders). Whilst sunset provisions have also become the norm in the Europe, market investors began to push-back on the certain terms during 2019. The majority of European loan agreements provided for 100bps protection with a 12-month sunset period, but six-month sunset periods became a common "flex" item in European deals, featuring in just 25% of European loan agreements in the first half of 2019, compared to 40% in 2018. 17% of deals in the third quarter of 2019 featured no sunset period at all.[13]

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 that is based on a fixed dollar amount and may also include a "grower" component based on a percentage of consolidated total assets or EBITDA. This "general basket" for liens is often tied to the size of the general debt basket. 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 MFN 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. Depending on the borrower's business, particularly the size of its foreign operations, if any, and credit profile, loan parties may be permitted to invest significant 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, permitted acquisitions 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 including a "grower" concept based on a percentage of EBITDA or total assets.

Investment covenant exceptions in U.S. deals have become fairly permissive, and the tightening and exercise of "flex" seen with respect to other provisions has not had a notable impact on the investment covenant in loan agreements. Deals still 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. Increasingly, all restricted payment and restricted debt payment capacity may be reallocated and 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 now more common for borrowers to choose from a variety of investment baskets for investments in unrestricted subsidiaries, including the general basket, the builder basket and the ratio basket. Some credit facilities also include baskets for investments in similar businesses and/or joint ventures. As discussed earlier in this Part B, some lenders are including a specific prohibition on transfers of material intellectual property to an unrestricted subsidiary. However, despite the media attention, the majority of credit agreements (even those in sectors with valuable intellectual property) still do not include direct blockers.

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). It is also now 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). With increasing frequency, European loan agreements are also permitting unlimited acquisitions provided the acquired entity becomes a "restricted subsidiary".[14] Soft-capped baskets for acquisitions and investments (where the monetary limit is

(i) based on the greater of a fixed amount and a percentage of earnings or asset value, and (ii) increasingly often, 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 (all referred to as "restricted payments"), and from making payments on subordinated and/or junior lien 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. U.S. deals are incorporating increasingly permissive restricted payment baskets, which mirrors investor comfort with expansive permitted investment capacity. For example, it is becoming more common (especially with better-rated credits) to allow loan parties to make a dividend consisting of equity in unrestricted subsidiaries. Such a basket, together with the 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 in 2018 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.[15] As noted previously in this chapter, these more borrower-friendly terms continue to gain traction in the market, but lenders have become more wary in extending such favourable treatment to lower quality credits.

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.

Builder Baskets

Most U.S. loan agreements also include a "builder basket", which is typically referred to as a "Cumulative Credit" or an "Available Amount" and represents an amount the borrower can utilise for investments, restricted payments, junior debt prepayments or other purposes. Traditionally, the builder basket begins with a fixed-dollar amount and "builds" based on the portion of excess cash flow not required to be used to prepay the term loans. Increasingly, borrowers are gaining the flexibility to have their builder baskets grow based on 50% of consolidated net income, rather than excess cash flow. 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. Use of the builder basket is often subject to compliance with a certain financial ratio test, especially when used for restricted payments or for junior debt prepayments.

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 12 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 70% of European senior secured leveraged loans through the first half of 2019 (up 4% on 2018 and 19% on 2017). Of these, almost all 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)[16] that are funded with the proceeds of a refinancing or re-pricing of the original term loans at a lower rate are common in the U.S. loan market. In some large cap deals, there are exceptions to call protection premiums for prepayments made 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 permit the borrower to offer to repurchase loans rateably 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. Many loan agreements also permit loan buybacks 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 purchased by sponsors or other affiliates that are not subsidiaries of the borrower may remain outstanding. Loan agreements often cap the amount that sponsors and such affiliates may hold and also restrict the right of such sponsors or affiliates (that are not *bona fide* debt funds) 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 term 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 (though less and less frequently), issuances of equity to third parties. If the agreement is for term B loans, as mentioned above, there will be an excess cash flow sweep, and the percentage of excess cash flow that is required to be used to prepay such term loans will decrease as leverage decreases. 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 of asset sales to prepay loans as leverage declines and allow the borrower to use asset sale proceeds to rateably 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. As a result, the "dead hand" proxy put is disappearing in the U.S. market.

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.[17]

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. Now, it is usually only agreements that govern a term A loan facility that contain an interest coverage or fixed charge coverage test.

In the U.S., "covenant-lite" loan agreements continue to dominate the leveraged loan market. However, data from S&P Global Market Intelligence suggests that these issuances may have peaked at the end of 2018 where they set record highs and accounted for almost 80% of outstanding loans. This portion of the market had increased steadily from approximately 64% in August 2015 but has inched lower since that peak in the fourth quarter of 2018. A covenant-lite loan agreement typically 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 and letters of credit are outstanding at the testing date (25%–35% is fairly typical, but this can be as high as 40%). 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; it merely reduces flexibility by limiting basket use.

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 2019 revealed that nearly 90% of loan transactions were "covenant-lite" (up from 81% 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.[18] In European loan "covenant-lite" agreements, springing covenants are typically tested only when the revolving facility is 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 excluded any revolving facility drawings made in connection with acquisitions or investments, or any closing date utilisations, from the calculation of the test trigger.

In the U.S., 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 2019 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 the continued success of higher-quality credits 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. In recent years, both U.S. and European loan documents have included broader and more numerous add-backs including transaction costs and expenses, restructuring charges, payments to sponsors and costs and expenses related to certain extraordinary and/or non-recurring 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 not-yet-realised 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. However, lenders in both the U.S. and in Europe are beginning to resist the expansion/flexibility of add-backs.

In the U.S., the Leveraged Lending Guidance and the federal regulatory agencies enforcing it (discussed further in Part D) have suggested 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 in 2019 for projected improvements in operating results, resulting in more frequent use of limits on the timing for the realisation of anticipated synergies and percentage caps on savings and synergies add-backs, typically 20%–35% of EBITDA in the U.S. As a result, some borrowers and sponsors turned to alternative lenders to whom such regulatory oversight does not apply.

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 20% in 2019.[19] However, lenders in the European market are increasingly aware of the pitfalls of including uncapped EBITDA add-backs in their loan documents. Indeed, the first half of 2019 saw a continuation of the decrease in the number of European deals containing uncapped add-backs (from 47% in 2017 and 33% in 2018 to 25% through the third quarter of 2019).[20]

Some U.S. deals do not limit the time period during which such cost savings must be realised or expected to be realised; however, it is typical for deals to include a time period ranging from 18 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 needs only to expect to have taken substantial steps toward realising such cost savings within the period.[21] These developments are further evidence of loosening loan terms and the power of sponsors, especially to the extent they can successfully market their deals as supported by a higher-quality credit. 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 "synergies" and "initiatives"). All this being said, arrangers in the U.S. have been successful through 2019 in relying on the market and general investor sentiment to limit lower-rated borrowers from taking advantage of this increased flexibility.

Equity Cures of Financial Covenants

For the majority of sponsor deals in the U.S., loan agreements that contain financial maintenance covenants (whether or not "covenant-lite") 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 some cases, arrangers have been successful in restricting the ability of sponsors to provide an equity cure in consecutive quarters.

In Europe, equity cure rights have been extremely common for many years. As in the U.S., 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 the first half of 2019, more than 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 U.S. in respect of the frequency and absolute number of times an equity cure right may be utilised. In Europe, the frequency has traditionally been lower (and usually, an equity cure could not be used in consecutive periods) and was 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 the majority of European loan agreements permitting consecutive cures in 2019 (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 continues to integrate "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.

The LSTA continues to explore alternatives for the actual replacement rate, but attention has largely focused on variations of SOFR. This is based on the LSTA's and ARRC's belief that SOFR is a secured risk-free rate that has a liquid and deep basis in treasury repurchase agreements. Currently, there are more than $1 trillion of underpinning trading activity. Some variations of SOFR are more similar to LIBOR, such as Forward Looking Term SOFR and SOFR Compounded in Advance, while others are less similar to LIBOR, such as SOFR Compounded in Arrears and Simple SOFR in Arrears. Following ARRC's September 2018 market consultation, it published final recommended fallback language in April 2019 providing that, upon a trigger event, a successor rate would be determined in accordance with certain specified rate and spread adjustment waterfalls. A survey of LIBOR fallback provisions in 132 new issue and amended institutional loans during the fourth quarter of 2019 indicated that ARRC's recommended approach is less common in the syndicated loan market than in the floating rate notes market, with only 33% of the loans reviewed following suit. Despite indications from ARRC that the "amendment" approach may not be operationally feasible on a large scale and that the predetermined terms may provide additional comfort to borrowers and the market, none of the reviewed deals used the ARRC's "hardwired" approach. The majority of deals – 69 deals in this sample – continues to provide for objection rights to the required lenders following an agreement between the borrower and the administrative agent on a successor reference rate. Less than 10% of the loans reviewed expressly provided that a new rate would not require lender consent, and only 1% provided that a new rate would require affirmative lender consent.[22]

In Europe, the LMA has continued to be proactive in preparing for the discontinuation of LIBOR by encouraging both borrowers and lenders to consider the implications of such a change in their loan documents. The LMA has produced a number of reports to supplement the precedent "Replacement of Screen Rate" clause and User Guide pertaining to the same, last updated in October 2018. In 2019, the LMA has focused in particular on the proposed adoption of two alternative risk-free reference rates: the Sterling Overnight Index Average ("SONIA") and the Euro Short-Term Rate ("€STR").[23] The LMA's "Replacement of Screen Rate" clause (or analogous provisions) appeared in almost all European loan agreements in 2019. However, the substance of these provisions were heavily negotiated, with more than half of the European first-lien loan agreements including substantive variations from the LMA precedent. The most prominent inconsistency between market participants concerns a difference in opinion as to which loan parties are required to consent to the replacement the existing screen rate. There are also notable differences in how any consequential adjustments to loan documents (necessary by virtue of the adoption of an alternative screen rate) should be effected. For example, whilst the LMA "Replacement of Screen Rate" provision specifically authorises adjustments to margin in conjunction with changing the benchmark rate, a significant number of alternative provisions in European loan agreements simply make generic reference to "consequential or incidental changes" as a result of a change in the benchmark rate.

However, the European market does seem to be making significant strides towards the adoption of LIBOR alternative rates. Further to the LMA's discussion paper on market conventions for referencing SONIA (published in conjunction with the Working Group on Sterling Risk-Free Reference Rates in March 2019), NatWest and National Express entered into the first revolving facility referencing SONIA.[24] The revolving facility circumvented the fact that SONIA is only available as a historic rate (on a T+1 basis) by applying a daily compounded rate with a five day reset lag, tracking the approach previously adopted in the bond and derivative market.[25] NatWest doubled-down on this approach, publishing the first online compounded SONIA, SOFR and €STR calculator (in response to a call for such a calculator from the Bank of England) in July 2019.[26] On 23 September 2019, the LMA also produced exposure drafts of: (i) a compounded SONIA-based sterling term and revolving facilities agreement; and (ii) a compounded SOFR-based dollar terms and revolving facilities agreement (the "Exposure Drafts").[27] The LMA is very keen to stress that the Exposure Drafts are not LMA recommended forms. They cite "*insufficient established market practice or infrastructure*" as the key reason for why the Exposure Drafts can only be considered "*focal points for consideration*", and note that the Exposure Drafts contain a greater number of blank placeholders and optional provisions than the LMA's recommended forms. However, the LMA does note that it is for market participants themselves to determine to what extent the Exposure Drafts are suitable as the basis for preparing loan documentation for transactions, and note that they envisage producing recommended forms as market practice and infrastructure develops in the relevant areas. The LMA is also explicitly seeking feedback from market participants on the Exposure Drafts, as the European market gears up to the transition away from LIBOR by the end of 2021.

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.

QFC Stay Provisions

In May 2019, the LSTA published a market advisory regarding the U.S. QFC Stay Rules and their application to U.S. global systemically important banking organisations ("GSIBS").[28] The rules also apply to worldwide subsidiaries of GSIBs and U.S. subsidiaries, branches and agencies of foreign GSIBs. At a high level, the rules require GSIBs to include new language in certain credit agreements if the loan documents also support the borrower's obligations under swaps or other qualified financial contracts. The LSTA has proposed model language, which is loosely analogous to the Contractual Recognition Provision required by the EU Bail-in Rule (discussed in detail below), and it is becoming more common for leveraged loan agreements in the U.S. to include the model language. As referenced above, the LMA produced a guidance note to its members on the U.S. QFC Stay Rules incorporating a link to the LSTA model language.

EU Bail In Legislation

On 28 January 2019, the LMA published a revised version of its user guide pertaining to EU Bail In Legislation.[29] The updates were largely mechanical, following the adoption of enacting legislation relating to Article 55 of EU Directive 2014/59 in Norway and Lichtenstein. Of the 33 EEA states required to enact domestic implementing legislation pursuant to Directive 2014/59, 32 have now done so, with only Iceland outstanding. The LMA user guide provides market participants with guidance on the terms of the LMA Bail In Clause, together with guidance on the requirements under Article 55. The LMA has also updated its recommended form of the Bail In Clause (within section 3 of the user guide). EU Directive 2014/59 (also referred to as the Bank Resolution and Recovery Directive, "BRRD") contains broad powers for EEA regulators to facilitate the rescue of failing EEA financial institutions. The BRRD confers power on the EEA regulators to write down and/or convert into equity failing institutions' liabilities. As a matter of law, those powers will be effective in respect of any liabilities under a document governed by the law of an EEA country, regardless of the terms of the relevant document. Article 55 of the BRRD speaks specifically to a scenario where an EEA financial institution assumes liabilities under a document which is governed by the law of a non-EEA country. Article 55 requires EEA financial institutions to include special terms into almost every document to which they are a party, in circumstances where that document is governed by the law of a non-EEA country. Under those special terms, the EEA financial institution's counterparties acknowledge that the financial institution's liabilities under that document are subject to an EEA regulator's powers of write down and conversion, (the "Article 55 Requirement"). The Article 55 Requirement applies to any loan market documentation governed by the law of any non-EEA country to which an EEA financial institution is a party, irrespective of the institution's capacity. In the context of European-based lending transactions, the most likely documents to be affected are security documents governed by the law of a non-EEA country. EEA financial institutions active in the U.S. are therefore likely to be impacted by the Article 55 Requirement, to the extent their documentation is governed by New York law.

Part C – Syndicate Management

Voting Thresholds

Traditionally 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. 2019 marked a tipping-point in the European market where, for the first time, more than half of European loan agreements defined "majority lenders" as a simple majority (as opposed to the traditional "two-thirds" 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 the U.S., the LSTA has recommended, and most loan agreements include, "deemed consent" of a borrower where a borrower does not object to proposed assignments within a period of 10 business days, which is the same position taken in the European market; however, it is increasingly common for "deemed consent" provisions to apply only to funded term loans. Similar to stronger European borrowers and sponsors who are able to negotiate a "blacklist" (as discussed below), most borrowers and sponsors in the U.S. 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 potential 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 U.S. 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. Borrowers generally have limited success in arguing that they should retain consent rights regardless of whether an event of default exists, but, in many cases, they retain the consent right unless the existing event of default is a payment, bankruptcy or solvency event of default.

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 whitelist), or not to a predetermined list of lenders (a blacklist). However, over the course of 2018 and 2019, there has been a marked trend in transfer restrictions. Indeed, restrictions on transferring commitments to "competitors" of the borrower were present in more than 84% of European loan agreements through the first half of 2019, usually without any reasonableness qualification (a slight increase on the same period in 2018). Another trend has been the increasing restrictions on transfers to loan-to-own and distressed investors, which in 2019 was seen in 84% of large-cap European loan agreements. For stronger borrowers in both Europe and the U.S., 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).

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.[30] 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.[31] Not surprisingly, adjusted leverage levels in the U.S. have increased and larger adjustments to EBITDA have increased unadjusted leverage even higher.

In June of 2019, a subcommittee of the House Financial Services Committee held a hearing to examine whether leveraged loans are systemically risky. There was no conclusion in the testimony as to whether loans currently pose systemic risk. However, the testimony brought light to concerns about whether loans could pose such a risk in the future and whether the loan market is too opaque for banking regulators to effectively monitor the inherent risks. Some of these concerns drew parallels to the financial crisis as certain Congressmen seemed to imply that the unexpected and massive failure of CDOs could repeat itself with CLOs and leveraged loans in the absence of effective regulation. Other Congressmen noted that these concerns are unfounded. The LSTA also considered the concerns to be misplaced given the historical performance of CLOs and their underlying loans as well as the structural protections for investment CLO securities. While it seems unlikely that proposed legislation in this domain will move forward in the immediate future, the LSTA will continue to follow the issue closely as Congressional leaders and community members continue to question the nature of the risk in the loan market.[32]

Similar leveraged lending regulations have 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.[33] 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).

Whilst the full effectiveness of the guidance remains in question, the level of supervision from the ECB has certainly increased since its introduction in 2017; banks were required to provide an internal assessment of their implementation of the guidance in November 2018, the ECB has started collecting quarterly data from the 18 most active supervised banks and a multi-year programme of on-site inspections was launched in January 2019. However, despite an improved effort from banks to implement the guidance, the ECB still regards excessive leverage as a key supervisory concern and will expect banks to implement more rigorous risk management practices in order to achieve full compliance with the ECB's risk management expectations.[34]

Net-Short Debt Activism

A recent development in the U.S. loan market has seen documentary protections introduced against activist investors holding net short positions, given the economic incentive for those investors to trigger manufactured defaults while maintain substantial positions in credit default swaps. However, some investors have resisted these protections, also known as "anti-net-short provisions" in light of the broader market trend towards borrower-friendly loan agreements and arguments that these restrictions negatively impact liquidity.[35]

The genesis of anti-net-short provisions in loan documentation followed the bankruptcy of Windstream Holdings, a communications firm, in February of 2019. Aurelius Capital Management became the holder of more than 25% of Windstream's senior unsecured notes, while holding a material net short position. Aurelius then issued a default notice attributable to the breach of a sale-leaseback covenant, which pushed Windstream further into distress and left Aurelius with a return on its short position.

As a general matter, anti-net-short provisions involve adding lenders who have been identified as net short (including, in some cases, lenders whose affiliates are found in such a position) to the deal's DQ list. Some investors resist these provisions on principle, while others credibly claim that representations covering affiliates are unworkably broad and logistically difficult to make. However, covering affiliates may be the most effective way for borrowers to root out activists from their lender group. As a result, borrowers now frequently push for this protection and will continue negotiating with arrangers to find a palatable balance for the market.

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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Acknowledgments

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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 2019. Like virtually every year since the financial crisis, lender ("Lender") Facility portfolios grew extensively this year, albeit at perhaps a slightly slower rate of growth than in recent years. The market has matured, growing more dynamic and accustomed to frequent evolution and change. This chapter summarizes the key developments in the Facility and Fund Finance markets in 2019 and forecasts our expectations for the coming year.

Cadwalader 2019 Representations

Because the Fund Finance market is not public, it remains challenging to find actual data to support anecdotal views. To help our clients address that, Cadwalader performs an annual data analysis where we evaluate every transaction in the United States in which we represented the lead Lender and compare the results to prior years. 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	2019	Change (%)
Number of Deals	111	185	315	+70%
Aggregate Lender Commitments ($bn)	$41.65bn	$58.28bn	$54.32bn	-7%
Number of Banks Participating in Our Deals	42	40	73	+83%
Number of Banks Represented by CWT	–	27	35	+30%
Average Deal Size ($mm)	375.23	315.04	172.43	-45%
Number of Sponsors	72	90	156	+73%

We draw on this data where relevant in this chapter.

Resilient Growth

In 2018, there were a host of headwinds that only somewhat muted the growth of the Fund Finance markets, including a decline in fund formation, one-sided and negative articles in the press, the Abraaj insolvency and updated guidelines published by the Institutional Limited Partners Association ("ILPA") that took a skeptical view of Facilities. But those headwinds largely faded into the rear view mirror in 2019. Fund formation, the fundamental driver of Fund Finance, rebounded materially last year. Fund sponsors raised nearly $900bn of committed capital, according to Pitchbook. The number of negative articles on Facilities declined significantly, and many investors were quoted in the press giving supportive views of the use of Facilities. The Abraaj insolvency has remained relatively quiet as to Facilities and the ILPA guidelines have had a very limited effect on market practice. Thus, with calm waters, the market continued its expansion.

We estimate global Lender commitments increased by 15–20% in 2019, in line with or slightly exceeding our 12–17% estimate for the year. We now estimate the global market at around $575bn. Most of the data points in our portfolio and the business metrics we track (number of deals (up 70%), number of discreet engagements, volume of hours billed, revenue, etc.) support these growth estimates. (Our numbers do include some growth by acquisition, not just organic growth, in that we added our hedge fund lending book into our data project in 2019.) Anecdotal reports from Lenders in the market often exceeded 20% for 2019 as well.

While not completely universal, that growth was observed in most components of the market. Yes, some of the new Lender entrants did a terrific job of establishing themselves as serious market participants in 2019. Many large transactions were awarded to new entrants. But virtually all of the incumbent Lenders, even despite the law of large numbers, grew their portfolios meaningfully on a percentage basis last year.

"Structural Drift"

Jeff Johnston, Managing Director at Wells Fargo, has used the term "Structural Drift" to describe how Facility terms continue to creep incrementally in favor of borrowers. Examples include the continuing increases in concentration limits and relaxation around investor credit linkage. But such drift seemed to slow a fair bit in 2019, and Facility structures for commingled Funds stayed relatively consistent. While the market is increasingly competitive, we have yet to see any major changes in transaction structures. We are seeing an uptick in transactions using a coverage ratio *in lieu* of a borrowing base.

Credit Performance

A. Abraaj. In a first for the modern Fund Finance market, an event of default on a Facility occurred in 2018 and was covered publicly in the press. But the press reports fell off in 2019 as new developments in the matter stopped being reported. As of the time of writing, the Abraaj matter really has not had a material impact on the market.

B. Ground Hog Day. While our portfolio grew extensively in 2019, outside of Abraaj, we were not consulted on any monetary events of default or institutional investor exclusion events last year.

Pricing and Tenor

Facility pricing held largely steady through 2019, with the average margin 8 bps lower in 2019 compared to 2018. We continue to see almost no correlation between the existence of an overcall limitation and Facility pricing… Nearly 40% of our 2019 Facilities had some form of overcall limitation in their partnership agreement. Tenor is more variable. Our 2019 portfolio is split as follows: 45% 1 year; 12% 2 years; and 29% 3 years. Only a small handful of deals extended beyond three years on a committed basis.

Industry Developments

A. Lender Hiring. Lenders continued to hire extensively in 2019, with experienced bankers in high demand. Long-time fund finance banker Jonathan Peiper joined Mizuho to lead their fund finance effort and Melanie Herald joined State Street in a leadership role. Many relationship managers joined new teams as well. The turnover has created a lot of career opportunities throughout the industry and upward pressure on Lender compensation.

B. Fund Finance Servicer Providers. The Fund Finance market had one of its first start ups in 2019 when long-time fund finance lawyers Zac Barnett and Richard Wheelahan formed Fund Finance Partners, headquartered in Chicago and Charlotte. Their company provides fund finance advisory and transaction management services to private equity fund sponsors.

C. Fund Finance Friday. Cadwalader's Fund Finance Friday weekly market intelligence and update newsletter expanded rapidly in 2019, now reaching a distribution list of over 7,000 readers. Not surprisingly, the job postings continue to lead the click count rankings. We also received great support from the market last year with submissions of third-party content, which we greatly appreciate. 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 fourth 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.[1]

E. FFA University. The Fund Finance Association ("FFA") hosted its first "FFA University" training event on September 17th–18th, 2019 in New York. The two-day event was sold out and 115 attendees completed the course, which was taught by senior members of the fund finance community.

2020 Forecasts

For 2020, we forecast a growth rate in Lender portfolios of 10–15%, although we make that estimate assuming that the coronavirus and the 2020 U.S. election do not materially alter the macro environment. We track a number of forward indicators, and all signs support this robust estimate. Our time accrued on prospective matters in January 2020 more than doubled that accrued in January 2019. Our new matters opened in January 2020 was up by 30%. This all builds on similar significant accelerations we saw in Q4 2019, so our current growth forecasts remain robust.

2020 Fund Finance Events

On February 12th–14th, 2020, the FFA hosted its 10th Annual Global Fund Finance Symposium in Miami, Florida at the Fontainebleau Hotel. Over 800 people attended the event, which was supported by nearly 100 distinct institutional sponsors. The headline speakers were tremendous: Hillary Rodham Clinton; Earvin "Magic" Johnson; Carlyle founder David Rubenstein; and Wells Fargo CFO John Shrewsberry. There were also a number of industry panels as well as more macro-oriented educational sessions, for example on the IPO market and Modern Monetary Theory. The 6th Annual European Fund Finance Symposium has moved to July and will be held in London on July 8th, 2020. The event's content committee is at work presently on the agenda. And the 4th Annual Asia-Pacific Fund Finance Symposium is moving from Hong Kong to Singapore this fall and will take place on November 11th, 2020.

The FFA is also planning the next edition of FFA University, targeting a September date in New York, and would like to host the program in London in 2020 as well. And the Cadwalader Finance Forum in Charlotte is close to announcing its fall date. More information to come.

Conclusion

The Facility market appears poised for another solid year in terms of portfolio growth in 2020. 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

1. 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

After record-breaking years in 2017 and 2018, the U.S. leveraged loan market dipped in 2019, ending on about two-thirds the volume of issuances (both principal amount and number of transactions). Drops in both M&A and other event-driven new-money financings and opportunistic repricings and refinancings each accounted for approximately half of the lower volume. Cross-border loans dipped even further, to about half of 2018 volume, driven in particular by far fewer loans with non-U.S. borrowers syndicated in the U.S. market.

This lower volume worked in favor of borrowers—continued demand for leveraged loans by investors depressed spreads and yield on new loans in the market on average. This average reduction in spreads, however, was driven by particularly strong demand for BB/BB- credits, while lower quality credits actually saw a slight increase in pricing. Investor concern over macroeconomic conditions and the effect of political events on the global economy – in particular trade disputes between the U.S. and China – caused a modest 'flight to credit quality' at the cost of yield.

The emphasis on credit quality impacted loans for leveraged buyouts in particular. After several years of increases, average leverage ratios at closing levelled off (and even decreased slightly for smaller transactions) in the face of a huge jump in the average purchase price for leveraged buyout targets. Buyout sponsors were forced to increase their equity contributions in order to make up the difference.

Overall, however, market conditions permitted loan documentation in the U.S. market to continue 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) U.S. LIBOR replacement

With the approach of the LIBOR sunset in 2021, U.S. market participants are hurriedly working to implement a successor rate. In late 2018, the Alternative Reference Rate Committee (***ARRC***), a committee organized by the New York Federal Reserve Bank (***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. 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 U.S. Treasury securities.

Since the announcement of the discontinuation of LIBOR, 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 endeavor to establish an alternative rate based on the then-prevailing market convention for determining such rate in syndicated loans in the United States. In 2019, it became more common for these amendments to reflect the language promoted by ARRC, although the language leaves room for several potential methods to calculate interest based on SOFR. ARRC and loan industry groups such as the Loan Syndication and Trading Association (***LSTA***) have generally promoted calculating interest rates based on compounded SOFR in arrears.

At the end of 2019, however, this approach had not been fully accepted in the leveraged loan market for a few reasons. The calculation fails to capture the term risk built into LIBOR. Borrowers that borrow at compounded SOFR will also be unable to accurately project their interest rate at the start of an interest period, and lenders lending at SOFR must train their operations teams and update their systems to accommodate their new rate. Finally, market participants are also hesitant because compounded SOFR is less able to deal with unexpected volatility in the SOFR, such as the 'surge' event that occurred in September 2019 when SOFR jumped two hundred basis points for 48 hours as a result of unexpectedly strong demand for more liquid investments nearing the end of a fiscal quarter when many corporate borrowers were planning for debt payments. That event has been projected to raise compounded SOFR interest rates by as much as 15 basis points for the backwards-looking period.

For all these reasons, market participants are still considering how best to implement SOFR in place of LIBOR, even while pressure to change continues to build. While LIBOR is expected to be discontinued in 2021, UK regulators have pressured banks to cease issuing LIBOR-linked loans by the third quarter of 2020 and market participants are scrambling to implement the change for both sterling- and dollar-denominated facilities before the FCA's accelerated deadline in order to remain competitive in the market for multicurrency loans.

(b) LSTA loan documentation

A growing trend in recent years has been the move towards standardized loan documentation in the U.S. market. The 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 2018, the LSTA published its first model credit agreement for revolving loan facilities. In 2019, the LSTA published a form of term-loan credit agreement and other model forms of common loan documentation. 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. Nevertheless, syndication banks and law firms active in the leveraged loan space have generally not adopted these models wholesale, and the form of documentation actually used in the market continues to be based primarily on that used in a precedent transaction agreed between the investment bank arranging the loans and the borrower.

(c) Tax Cuts and Jobs Act

Another legal development we have watched for the last few years is the impact of the Tax Cuts and Jobs Act, which reduced the corporate tax rate and the caps imposed on deductions for net business interest expense, limited deductions for interest paid to foreign related parties (affecting 'push downs' of debt to U.S. affiliates of non-U.S. borrowers) and carved a path to implement expanded share pledges and guarantees that would not previously have been possible without adverse effects on the tax code. The legislation does not appear to have had a significant impact on the loan market generally or have led to expanded security packages on new debt, except perhaps for distressed companies.

(d) Net short investors

A net short investor is any investor in a company's loans or bonds that has also invested in credit default swaps with respect to those loans or bonds in such an amount that the investor will profit more from the swap if the company defaults under that loan or bond than if the company complied with its covenants and repaid its debt obligations as they came due. Net short investors therefore have an economic incentive to cause a borrower to default under its debt documents, which may make it more difficult for borrowers to obtain from lenders a waiver of a default or an amendment.

Two legal developments in February 2019 shined a spotlight on the impact of net short investors in the syndicated loan market. The first was a court decision in a widely publicized dispute between Windstream and Aurelius Capital Management, a net short investor of Windstream's bonds. In 2017, Aurelius bought Windstream bonds and declared Windstream in default of a restriction on sale-leaseback transactions in its debt documents due to a transaction it had consummated in 2015. Windstream denied any default occurred and a lawsuit was commenced. Aurelius is widely believed to have amassed a large credit default swap position at that time and offered to settle the lawsuit only if Windstream declared it was in default under its debt documents. The court determined that Windstream had indeed violated the covenant and Windstream shortly thereafter filed for bankruptcy protection, which is believed to have resulted in large payments to Aurelius under their credit default swap positions.

The second development was a lawsuit brought in by United Natural Foods, Inc. against Goldman Sachs arising from Goldman's role as the lead arranger of the credit facilities supporting UNFI's acquisition of the Supervalu grocery store conglomerate. UNFI alleged that Goldman had breached various contractual obligations and fiduciary duties because Goldman had proposed structuring the debt as an amendment to the company's existing credit facilities rather than a refinancing. UNFI alleged that Goldman persuaded them to use this structure for the benefit of debt investors who held credit default swaps that would have terminated if the existing debt documents were terminated in a refinancing. UNFI claimed that the terms of their debt facility after syndication were worse than it would have received with a true refinancing. As of the date of publication, this proceeding was still ongoing.

As a result of these developments, a few loan agreements and bond indentures have incorporated so-called 'anti-net short provisions' that are intended to discourage investors with net short positions from purchasing a company's loans or bonds in the secondary market. These provisions typically do one or more of the following: limit the time a lender or agent has to declare a default; require each debt investor to represent whether it has a net short position; prohibit net short investors from purchasing loans in the secondary market; restrict any net short investors' access to information; and/or disenfranchise debt investors currently in the syndicate that later become net short investors with respect to voting on matters that require lender consent (most importantly with respect to enforcement of the loan). These provisions have not yet been widely adopted in the market, but this is a development that market participants will continue to watch in 2020.

(e) Direct lending

Direct lending refers to non-broadly syndicated debt provided by unregulated institutions. Direct lenders include standalone credit funds, credit funds affiliated with private equity funds, pension funds, unregulated affiliates of commercial banks, hedge funds, business development companies and unregulated investment banks. Since 2010, the volume of direct loans has doubled to nearly $700 billion annually, and the size of individual facilities has increased such that direct loans may replace or complement traditional syndicated facilities. Direct lending challenges the distribution role of traditional investments banks in the syndicated loan market, and the growth of direct lending removes significant transactions from oversight of bank regulators. Most expect direct lending to continue to grow and reshape the TLB market in coming years.

Economic Terms

Pricing

In 2019, as noted above, margins generally declined from 2018 levels, although lower rated credits saw some increase in pricing. Pricing per unit of leverage declined overall, however, indicating that the market as a whole was comfortable with increased leverage levels.

Since 2018, LIBOR has floated well above the typical floor rate, so leveraged loans have been true floating rate instruments for several years now, just as they were before the financial crisis. In the face of further interest rate cuts, however, more lenders pushed for a LIBOR floor greater than zero in the second half of 2019 than had been the case in 2018 or the first half of 2019.

Optional prepayments

Unlike bonds, investors still generally accept that a TLB is repayable without penalty or premium. The volume of repricings overall was suppressed in 2019 due to the flight of investors toward better credit quality. For higher quality credits, repricings jumped in the fourth quarter of 2019, and there was an explosion of repricings in January 2020. This shows that borrowers continue to take 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 2019, soft call protection provisions typically included a 'sunset' of six months, although some 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 2019.

Mandatory prepayments

Mandatory prepayment requirements that became slightly more onerous in 2018 loosened some in 2019, continuing the overall trend for the 2010s in TLB that lenders have pulled back from requiring borrowers to delever with excess cash. In particular, a provision common in large sponsored loans that provides 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) became more common in non-sponsored loans and middle-market loans. The amount of delevering required to decrease the percentage of asset sale proceeds required to be used to prepay also decreased.

In addition, there were other borrower-friendly trends in mandatory prepayments that continued in 2019. 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 general decrease in volume in 2019, some loans experienced successful investor pushback on loose provisions, particularly in lower quality credits. Overall, however, investor pushback focused much more on pricing and yield, and there were relatively modest steps to the benefit of investors in the overall movement for the past decade toward covenants that are more favorable for borrowers.

In 2019, 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 remained a major focus for investors in 2019 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 2019, 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 2019 were 'cov-lite', but perhaps more noteworthy was that fully 85% of non-sponsored leveraged loans were 'cov-lite' and nearly three quarters of middle-market deals were also 'cov-lite'.

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. How letters of credit are to be calculated in the leverage covenant remained a hot button issue with respect to 'springing' maintenance covenants in 2019, and some sponsor loans excluded not only undrawn letters of credit from leverage calculations, but all revolving borrowings as well.

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 2019 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 basis points, although borrowers have been able to achieve 75 or 100 basis points 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 2019. 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 2019. The incidence of sunsets decreased in the second half of 2019, 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). In 2019, more and more loans 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. It is also increasingly common to permit the use of incremental facilities, incremental equivalent debt and other ratio-based debt baskets for acquisitions even if the borrower does not currently comply with the financial ratio so long as the ratio is the same or better after consummation of the acquisition on a *pro forma* basis – a so-called 'no worse' prong to debt incurrence. Borrowers argue for these provisions noting that growth benefits lenders with a larger collateral pool and increased EBITDA. Lenders are hesitant to increase the debt load of companies that cannot meet the ratios otherwise agreed for new debt based on *pro forma* projections that may not be achieved.

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.

Day-one debt capacity. Under most loan documents, borrowers are able to access rights to incur additional debt immediately, and the amount of debt that could be borrowed immediately after making a loan was an area of investor attention in 2019. For example, the incremental 'freebie' basket is in many cases sized at the equivalent of 100% of Consolidated EBITDA. Investors focused particularly on the amount of first lien debt that could be incurred immediately and whether that debt could be structurally senior to a new TLB facility as a result of, for instance, being incurred by a subsidiary that was not a guarantor of the parent's facility. While it is unclear whether the attention paid by investors in 2019 to these provisions resulted in significantly different terms, investor focus may lead to more push-back in 2020.

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, nearly half of loans to sponsor-backed borrowers and nearly a third of non-sponsored loans in 2019 permit unlimited investments in subsidiaries that are not required to accede as guarantors, and this is particularly common where a borrower has significant non-U.S. operations or a non-U.S. growth strategy. The borrower generally remains subject to the overriding requirement that material subsidiaries must become guarantors and grant security. The level of materiality before a subsidiary is subject to these requirements is heavily negotiated, as well as whether materiality is determined solely by reference to the EBITDA or also assets of each subsidiary. As a result of these limitations, loans 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', 'Cumulative Amount' or more colloquially, 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 (an issue of focus for investors, as noted above). 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 realized 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 realized 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 realized within the agreed period but rather require only that the borrower have taken substantial steps toward (or in some cases, only state that it has committed to) completing the reorganization or acquisition that will give rise to the expected cost savings within the agreed period. Finally, the cap on the amount of EBITDA add-backs has either increased (in 2019, this settled most commonly at 25%) or been removed. Just less than half of large syndicated TLB facilities in 2019 permitted such add-backs without a cap, a marked decrease from 2018, and add-backs without a cap were rarer still in smaller TLB facilities, appearing in around 30% of middle-market deals (also a decrease from 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, as well as the new focus on net short investors mentioned above, 2019 continued to see 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.

Conclusion

In spite of a drop in volume for the U.S. leverage finance market in 2019, covenant packages remained relatively steady or moved slightly further toward increased flexibility in favor of borrowers. 2019 is evidence that, without a drastic market change, TLB covenant packages seem likely to continue to erode in favor of increasing bond-like flexibility even when market fundamentals seem to shift in favor of investors. Investors seem willing to sacrifice document terms for higher yield—a tradeoff that borrowers are willing to make. As the start to 2020 has seen a sharp rebound in leveraged loan volumes, barring a drastic change in external economic prospects, further erosion of covenants coupled with downward pressure on pricing seems likely in the upcoming year.

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The Continued Prevalence of European Covenant Lite


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In 2019, 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 and bond market terms into European loans remains strong as there is now a significant source of European "cov-lite" precedents to such an extent that cov-lite loans are now considered customary for European leveraged finance syndicated loan transactions (not, to date, in direct lending transactions) and will likely continue to be so considered in the absence of a market correction. Investors were, however, more successful on pushing back on certain pricing and documentation terms during 2019. The use of terms that originally were designed for high-yield bonds augurs for consideration of a number of documentation issues.

Covenant-lite Loans

In a covenant-lite loan, typically there is a single financial covenant and it is 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 almost always is a "springing" covenant, i.e., tested only if the revolver is drawn as of the end of a fiscal quarter (often first tested from the second or third complete quarter after the closing date) and such usage exceeds a certain percentage of the revolving facility commitments (often 35–40%) with the applicable levels set with significant EBITDA "cushion" or "headroom" (from financing EBITDA included in the base case model) of around 30% or more, and with no step downs. The type of drawings that are included in the calculation of the trigger is also narrowing to exclude all ancillary facilities and letters of credit, amounts utilised to fund fees, costs and expenses and flex at closing. In certain deals, cash and cash equivalent investments are deducted from the amount of revolving facility commitments that are drawn at the relevant testing date (with cash, unlike in an LMA-based credit agreement, not being defined).

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, has been accepted on cov-lite deals in Europe for quite some time. Interestingly, the European market generally permits over-cures, whereas the US market limits cure amounts to the maximum amount needed to ensure covenant compliance. Another divergence between European cov-lite loans and US covenant-lite loans is the prevalence of deemed cures in European cov-lite loans, which are rarely if ever seen in US covenant-lite loans. It is, however, 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. Another interesting development in relation to equity cures in European cov-lite loans is the ability to prepay the revolving facility below the springing threshold within the time period a debt or EBITDA cure could be made following testing of the financial covenant (such that it is deemed not to be tested rather than actually curing the breach).

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 terms that were based on looser US practice at the time. 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 what in prior periods were regarded as "traditional" loan market baskets fixed at a capped amount. A more dramatic departure from US practice is the approach that has caught on in Europe to base the reporting requirements, affirmative covenants, negative covenants, and events of default on high-yield bond-style terms, and which are tacked onto the English law-governed secured facilities agreement as schedules interpreted under New York law (much like the format of a super senior revolving facility).

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 or separate "sidecar" financings. European cov-lite loans may also permit acquired or acquisition debt subject to a "no worse than" test in terms of the leverage ratio of the group *pro forma* for the acquisition and incurrence of such debt (although this has seen investor pushback in certain transactions). 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 (often with no parameters as to where the debt can be incurred within the group). 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 six or 12 months – unlike the US cov-lite loan market where sunsets continue to be more common), carve outs of certain debt baskets (acquired and acquisition debt and the freebie basket) and whether it applies to side cars. Other more recent areas of focus from investors have been the inclusion of a non-guarantor debt cap and whether revolving facility drawings are excluded from ratio testing (the latter point still being in a small minority of deals in Europe despite being quite common in the US).

Builder Baskets

Another durable trend from the US cov-lite loan market (which is a long-standing feature of the high-yield bond market) that has been adopted in European loan deals is a "restricted payments builder basket" (the so-called "Available Amount"), 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, unswept asset sale proceeds and (perhaps most aggressively) permitted indebtedness, usually subject to a net leverage ratio governor as a condition to usage. Typically there is no limit to distributions (or the source of financing such distribution) if a certain leverage ratio test is met. An even more aggressive variant based more closely on the high-yield bond formulation that has become commonplace 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", usually soft capped by reference to EBITDA and in certain deals there is a "floor" on the CNI builder basket such that unlike bond transactions where 100% of losses are deducted from the CNI builder basket, no losses are deducted.

US-style Events of Default

While previously US-style events of default continue to be resisted by European loan syndicates, it is now more customary for loan financings to include defaults more akin to the US loan approach (such as removal of material adverse change default and no audit qualification default) or, more typically, 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.
- EBITDA addbacks (as used in financial ratios for debt incurrence purposes) that are uncapped or more commonly, capped per individual action rather than per relevant period. It is now unusual to see any third party verification of addbacks and realisation periods can extend to 24 or 36 months in certain deals.
- 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 acceleration rights).
- Greater restrictions on transfers to competitors and "loan to own" funds, with more limited default fall aways (e.g. payment and insolvency only).
- The inclusion of a "covered jurisdiction" concept whereby guarantees and security will only be given in a pre-defined list of jurisdictions (as opposed to all jurisdictions other than those which the agreed security principles will exclude).
- A more limited security package consisting of material bank accounts, shares in Material Subsidiaries and intra-group receivables in respect of proceeds loans.

While anti-net short provisions (limiting the voting rights of lenders that hold a net short position in respect of the relevant credit) have begun to emerge in the US syndicated loan market, such feature has not yet appeared in European cov-lite deals.

Economic Adjustments

Economic adjustments such as a 101% (or 100.50%) soft call for six or 12 months, a EURIBOR or LIBOR floor, and nominal (0.25%) quarterly amortisation are also often introduced to make loans more familiar to US loan market participants. Other relevant considerations for a US syndication in respect of a European credit include all asset security (which is typically expected in the US), whether a disqualified list in respect of transfers will be used instead of a more European approved list concept and the inclusion of a US co-borrower in the structure.

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.

Provisions allowing the incurrence of third party debt do not typically require the debt providers to sign up to the intercreditor agreement unless they are sharing in the security package. With more flexibility to incur third party debt, it is very possible that an unsecured creditor (or a creditor that is secured on assets that are not securing the cov-lite loan given the more limited security package) 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 seeing requests 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) but most cov-lite deals do not include this requirement.

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 2020?

It seems likely that low interest rates may continue to prevail in Europe, 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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An Introduction to Anti-Net Short Provisions in Syndicated Loans

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Introduction

Among the most significant legal developments of 2019 in the U.S. syndicated loan market was the introduction, and increasingly widespread adoption, of the so-called "anti-net short" credit agreement provisions.

This rough collection of terms represents a creative, but in some respects technically imperfect, innovation, that was borne from market forces and circumstances that challenged the conventional wisdom around lender incentives and behavior. In particular, the notion that lenders[1] would always prefer repayment in full over a borrower default or bankruptcy, and the assumption that lenders will act in a manner consistent with that desired outcome, have been upended by the emergence of so-called "net short debt activist" investors. These "rogue" lenders are in many ways anti-creditors and have crafted a means to profit from the default or bankruptcy of a borrower—and in so doing, have weaponized their role as a lender to the peril of the debtor, its equityholders and even its other lenders.

Faced with the potential of an existential threat – as experienced by Windstream Holdings, as discussed below – borrowers (often at the behest of their private equity sponsors and counsel) have developed their own defense system by adding protective features to their credit agreements to insulate themselves against "net short lenders" and prevent net short debt activists from capitalizing on opportunistic or historical defaults to push a borrower into distress or even bankruptcy.

Nearly a year after their introduction, this bundle of terms continues to evolve and remains unsettled – and unsettling – among market participants. Moreover, there have been few test cases outside the U.S. to determine if other markets (most notably the UK and Europe) will accept the provisions and, if so, in what form.

As we head into 2020 and some of these mechanics have begun migrating to the UK and European loan markets, parties on both sides of the Atlantic are well advised to familiarize themselves with their purpose, scope and implications.

Who Are Net Short Lenders?

A net short lender is any lender that would stand to profit from the distress or demise of the borrower as a result of outsized holdings of credit default swaps ("CDS") or equivalent derivative instruments that pay out the occurrence of certain credit-negative triggering events, such as the bankruptcy of the borrower. Implicit in this investment position is the existence of an inverted incentive structure for net short lenders as compared to "normal" lenders that desire first and foremost to sustain or enhance value, and avoid adverse developments or financial distress, at their debtors.

Moreover, as a result of its prospect of profiting from a debtor's failure, a net short lender may have a financial incentive to take it a step further and become a net short debt activist investor. Net short debt activism involves a lender employing strategies to proactively utilize its position as a creditor to identify and act upon historical or technical defaults (often referred to by market commentators as "manufactured defaults") for the purpose of triggering a payout under CDS or other credit derivative positions, to the detriment of the borrower and its other stakeholders.

In this way, net short lenders turn certain fundamental assumptions around creditors' motivations on their head, to the dismay of borrowers, financial sponsors and, importantly, other lenders.

With that said, an overall short position does not alone mean a lender is hostile. Nor does it call into question its motivations or predict its likely course of action. There are various benign reasons a lender may be net short at any time or for a period of time (including, for example, a hedging strategy temporarily out of balance, market volatility or the overlapping of distinct investment strategies). Nonetheless, as drafted, anti-net short provisions apply to all lenders (other than the unrestricted lenders described below) without regard to motive.

What Are Anti-Net Short Provisions?

Anti-net short provisions consist of a collection of terms contained in syndicated credit documentation that seek to limit the presence and influence of lenders that have an overall "short" position with respect to the borrower under the facility. Because of its "short" position, unlike conventional lenders, who would virtually always prefer repayment, a "net short lender" stands to benefit economically from a default or bankruptcy of the borrower.

To diminish the potential damage that can be caused by this scenario, anti-net short provisions seek to, among other goals, prevent net short lenders from asserting a default, initiating remedial actions or voting in any lender decision, particularly those relating to the lenders' exercise of remedies.

Disenfranchisement of specified types of lenders is not itself a new phenomenon for syndicated loans. This tactic has been widely used for a number of years to limit the rights of lenders that are affiliates of the borrower (e.g., a financial sponsor). Prohibiting those lenders – whose interests would likely deviate from unaffiliated lenders in a workout scenario, for example – from voting or accessing certain syndicate-level information has been likened to keeping the "fox out of the henhouse" and viewed as a prerequisite to allowing those affiliated lenders to acquire loans. It is this same logic that underpins disenfranchisement of net short lenders as a fundamental component of the anti-net short protections.

Taking this theme one step further, net short lenders are also restricted from submitting any notice of default or administrative agent instruction to exercise remedies under the credit documentation. In effect, they are silenced and forced to be passive *vis-à-vis* the borrower for the duration of their investment, so long as they remain net short.

In the same vein, credit agreements with anti-net short provisions seek to prevent net short lenders from buying into the deal in the first place. Assignments and participations are often required to include representations by the purchaser that it is not, and will not become as a result of the trade, net short with respect to the borrower. Essentially any entity that is or would be a net short lender becomes a disqualified institution for all purposes under the credit agreement.

A less common feature that has appeared in a minority of deals entitles the borrower to replace net short lenders (through use of the customary "yank-a-bank" mechanic) or repay that lender on a one-off, non-*pro rata* basis, thereby ridding the syndicate of an offending investor.

Where Did They Come From?

Windstream Holdings Inc.'s court battle with one of its bondholders, and its subsequent bankruptcy filing in early 2019, immediately precipitated the introduction of anti-net short protections in U.S. financings.

Windstream's agitating bondholder reportedly held a net short position and took actions blatantly hostile to the business and ultimately damaging to its equityholders and other creditors. It was widely reported at the time that the offending bondholder was set to profit from its outsized CDS position with respect to Windstream's debt, thus drawing into sharp focus the real and present danger of net short debt activist investors.

In the wake and as a result of this case, borrowers and financial sponsors quickly began introducing the anti-net short defenses discussed in this article. As is often the case with innovative technology in the ever-changing syndicated loan market, the terms quickly caught on and spread like wildfire. In light of this origin story, the anti-net short provisions are sometimes referred to as the "Windstream Provisions."

Where Have They Been Adopted?

Since their inception in the U.S. market in the spring of 2019, the anti-net short provisions have largely been confined to broadly syndicated domestic term loans. This reflects the fact that U.S. borrowers have, to a degree, less control over who trades in and out of their lending syndicate when the loans are widely held and liquid. As a result, the types of investors most likely to become net short lenders (whether intentionally or inadvertently by employing complex hedging strategies) have easier access to the borrower's debt and the ability to be disruptive for the credit group.

In contrast, closely held loans are subject to tighter marketability restrictions and, as a result, are less susceptible to the influence of net short debt activists. Additionally, the availability of CDS or similar derivatives for bilateral or club loans may be limited or nonexistent, thereby removing the primary means of achieving net short status (ignoring for this purpose any equity position in respect of the borrower, which to date has remained outside the scope of anti-net short provisions) for purposes of the loan documentation.

As with many innovations in U.S. credit documentation, the anti-net short provisions have gradually started migrating to the European market. As of the writing of this article, at least one UK deal has been signed with a modest version of these terms intact. It is too soon to tell, however, if the features will stick in overseas facility agreements, or if and in what manner they will deviate from the U.S. approach.

Whom Do They Affect?

With the exception of a subset of "unrestricted lenders," all lenders under the relevant credit agreement are subject to anti-net short provisions.

Unrestricted lenders are typically defined as (i) lenders under the revolving credit facility (sometimes limited to those lenders party to the revolver at closing), (ii) the arrangers and administrative agent for the financing, (iii) regulated entities (including banks and registered swaps dealers), and (iv) all respective affiliates of the foregoing.

As the unrestricted lenders definition illustrates, the primary target of these provisions are non-bank term loan lenders. This is because the syndicated term loan (and, more specifically, the "TLB" tranche) is the more liquid and heavily traded paper, thus more appealing (and accessible) to the types of funds that seek short-term profits.

Where Are We Heading?

It is still early days in the evolution of the anti-net short provisions in the U.S. syndicated loan market. Across the Atlantic, it is yet to be seen if they will take hold at all, and if so, in what form. One certainty, however, is that these innovative terms will continue to evolve and draw attention from market participants for the foreseeable future.

Endnote

1. This article speaks to borrowers and lenders in the syndicated loan context, but much of the substance applies to issuers and holders of high-yield bonds as well.

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Liability Management: Exploring the Practitioner's Toolbox

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Introduction[1]

The relationship between creditor and debtor can be simple or complicated, friendly or adversarial, profitable or costly, all depending on the circumstances. While in most situations economic incentives are aligned – creditors want to earn interest income and have their principal repaid at par and debtors want to grow their business and repay their indebtedness in full – an inherent conflict remains between those lending money and those borrowing it. This conflict is present throughout the lifecycle of a lending transaction, but it is most acutely obvious during the initial negotiation of terms and when the debtor is considering a potential liability management transaction – with the former often setting the boundaries for what is possible in the latter.

Creditors have traditionally used negative covenants as a means of ensuring that a debtor will not take any actions that would negatively impact the creditors' ability to fully recover on their investment. In addition, creditors use financial covenants to monitor a debtor's financial health and provide an early warning signal of potential deterioration in the debtor's financial performance. Historically, debtors were comfortable, to varying degrees, with the restrictions imposed by the combination of negative covenants and financial maintenance covenants. Relationships were the key to that comfort. Debtors saw creditors as partners who would be willing to consent to actions that make commercial sense for the business, who would not impose their own judgment over that of management and who would not extract costly consent fees at every opportunity. On this basis, debtors were often willing to live without an extensive list of covenant exceptions mitigating the restrictions in their financing agreements.

In recent years, however, relationship lending has increasingly given way to syndicated lending – particularly in the term loan market.[2] In this new environment, debtors cannot assume that they will be able to obtain permission from creditors easily and without cost. As a result, when debtors, particularly those backed by private equity sponsors, are negotiating financing agreements, they now place a high priority on ensuring broad flexibility to operate and implement strategic plans without having to seek creditor consent and on minimising the possibility that creditors will leverage their ability to withhold consent in order to obtain concessions or more favorable economics from the debtor. In recent years, certain covenant exceptions have emerged to give debtors the flexibility to execute on liability management transactions – in some cases foregoing creditor consent completely.

Not surprisingly, creditors have countered this development by seeking to rein in the tools used by debtors in liability management transactions. While creditors have had some success in their attempts to address specific loopholes in the relevant clauses, modern financing agreements continue to provide many avenues that a debtor could use to pursue a liability management transaction. The dynamic between creditors and debtors regarding these transactions is further complicated by the fact that there is no one-size-fits-all solution for liability management, as each debtor's circumstances and needs are unique. Debtors should be mindful to consider the impact that any concessions made in connection with a liability management transaction will have on the debtor's ability to undertake subsequent liability management transactions; creditors will likely seek to tighten covenants in a way that will limit the debtor's options for liability management transactions. Debtors with more than one tranche of indebtedness will also need to consider how a liability management transaction undertaken with the consent of one class of creditors will affect the debtor's relationship with its other creditors.

Debtors and creditors also need to consider the circumstances leading to the liability management transaction. Debtors generally pursue liability management transactions because of one of three reasons: the upcoming maturity of one or more classes of indebtedness; a potential breach of a financial covenant; or pressure on the company's liquidity. Each of these situations presents a unique challenge that will dictate the debtor's strategy for designing and executing any potential liability management transaction.

Examining the case in which the debtor has a credit facility with an upcoming maturity provides an instructive example of how liability transactions come about. In this case, the debtor will either approach its existing creditors asking them to agree to extend the maturity of the existing indebtedness or attempt to identify a new group of creditors that are willing to provide the debtor with longer-dated debt, the proceeds of which will be used to repay the existing debt. Depending on the debtor's financial performance, the extended indebtedness can often have a higher interest rate than the predecessor debt, thereby saddling the company with a higher cost of capital. But if a new group of creditors willing to refinance the existing indebtedness cannot be found, a debtor will need unanimous (or, in limited cases, near unanimous) support from its existing creditors in order to extend the maturity, thus providing potential holdouts with significant leverage if the debtor does not have an alternative path. Liability management transactions provide such an alternative path.

In this article we will explore a variety of the strategies frequently used in a liability management transaction. These range from a basic "kick the can down the road" approach, to shifting the nature of the capital structure, to the secretion of assets out of the credit group entirely in order to achieve a variety of outcomes. The breadth of options in an out-of-court transaction will be dictated by what is permitted by the existing financing agreements around which the debtor may be looking to structure the transaction. In most cases, these tools are not used in isolation; instead a debtor will seek to deploy them in combination to structure a transaction that achieves the desired result while bringing along the necessary creditor constituencies needed to execute the transaction.

Uptiering, Exit Consents and Other Refinancings

One primary strategy used by debtors seeking a liability management transaction is to uptier a class of existing indebtedness. Uptiering may take the form of increasing the priority of the liens securing the indebtedness (e.g., exchanging second lien indebtedness for first lien debt), improving the position of such indebtedness in the payment waterfall (discussed in detail below) and improving the structural priority of the indebtedness (e.g., moving the indebtedness closer to the assets in such a way as to structurally subordinate other indebtedness).

In 2017, Cumulus Media Holdings, Inc. and Cumulus Media Inc. sought to enter into an uptiering refinancing in which $610 million of unsecured bonds would be refinanced with a draw on the company's existing revolving credit facility and a new incremental revolving credit facility. The new revolving credit facility would rank *pari passu* with the company's existing revolving and term loan credit facility. Cumulus' term loan lenders successfully objected to the proposed restructuring arguing that it violated the credit agreement because the refinancing of unsecured indebtedness with secured indebtedness was not a "permitted refinancing" – even if the company had capacity under its debt covenant to facilitate such a transaction. The Cumulus transaction underscores the importance of both ensuring that proposed transaction strictly complies with all applicable provisions of a financing agreement and the need for practitioners to carefully draft financing agreements to avoid ambiguity and conflicts between interconnected provisions of a financing agreement.

Another tool available to debtors considering a liability management transaction is the exit consent. In an exit consent transaction, creditors who have agreed to refinance or exchange their existing holdings amend the terms of the legacy financing agreement prior to such refinancing or exchange in order to incentivise other creditors to participate in the refinancing or exchange transaction. The amendments to the financing agreement often include the elimination of negative covenants so that the non-consenting creditors will have little to no independent covenant protection. Exit consents are typically used as part of a broader liability management transaction. Any debtor considering such a transaction should carefully consider the scope of what is being eliminated from the financing agreement to ensure that the proposed transaction complies with the financing agreement and applicable law. For European deals governed by the law of England and Wales, courts have taken an even more sceptical view of exit consents and they are generally not permitted.[3]

Pro Rata Treatment of Creditors

A key set of provisions in financing agreements are those governing *pro rata* sharing. These provisions mandate (1) that all creditors within a given class share equally in all payments (including both mandatory and voluntary prepayments) on the indebtedness, (2) that any creditor that received a payment in excess of its *pro rata* share turn over the excess amount to the agent for ratable distribution to the other creditors, and (3) a payment waterfall that applies to the proceeds of collateral or payments on the outstanding indebtedness received by the agent or creditors after and during an event of default. Historically, *pro rata* sharing provisions have been treated as a fundamental right and amendment or modification of such provisions has required the consent of either all creditors or all creditors adversely impacted by the change. As financing agreements have become more borrower-favourable, the requirements to amend *pro rata* sharing provisions have become less onerous, with many financing agreements for portfolio companies of large-cap financial sponsors now only requiring majority or super-majority consent to effect such an amendment.

If a debtor is able to amend the *pro rata* sharing provisions without the consent of all creditors, the debtor has the flexibility to structure a potential liability management transaction if it can garner consensus among a majority or super-majority of the applicable class of creditors, without the worry of a minority holdout being able to block the transaction. A debtor can utilise the *pro rata* provisions to improve the priority of a class of indebtedness or to provide that one class of indebtedness will benefit from specific payments on indebtedness that will not be used to repay other classes of indebtedness. In addition, while the *pro rata* sharing provisions are intended to ensure equitable treatment of creditors within a class, they often do not prevent the introduction of a new class of creditors, which may be entitled to rights and benefits that do not accrue to the other classes.

In a situation where a financing agreement governs indebtedness of multiple classes, the creditors may be able to amend the *pro rata* sharing provisions so that the priority of one class of indebtedness is elevated above that of another class of debt. This uptiering of indebtedness can be used as an incentive for creditors to consent to a transaction. For example, a debtor, facing an upcoming maturity, may offer to improve the priority of a class of indebtedness if those creditors agree to extend the maturity of the indebtedness.

Debtors may also use an amendment to the *pro rata* sharing provisions to permit payments on indebtedness to benefit one group of creditors over another, by providing that those creditors who consent to a transaction are entitled to payments to which non-consenting creditors are not entitled. This too creates an incentive for creditors to consent to a liability management transaction.

By using the flexibility contained in a financing agreement, a debtor may be able to introduce a new class of indebtedness. For example, creditors holding a majority of an existing class of indebtedness may be able to amend the financing agreement to permit the creation of a new class of super-priority indebtedness, which thereby decreases the priority of the existing indebtedness.

It should be noted that it is yet to be seen how a bankruptcy court will treat amendments to the *pro rata* sharing provisions that effectively subordinate the rights of a class of creditors without such creditors' consent. Accordingly, parties seeking to engage in this sort of transaction should be careful to ensure that the transaction is clearly permitted by the contract governing the indebtedness and be prepared for such transaction to be challenged.

Unrestricted Subsidiaries

Most modern financing agreements include the ability to designate a subsidiary as an "unrestricted subsidiary", which is not bound by the covenants and restrictions contained in the financing agreement. Traditionally, debtors designated subsidiaries as "unrestricted" in order to isolate non-core elements of the enterprise, such as a startup enterprise or an entity that would be used as part of a receivables financing or as an escrow subsidiary. Recently, however, debtors have become more creative in their use of the virtually unlimited flexibility provided by an unrestricted subsidiary in order to structure complex liability management transactions that would not be executable by entities covered under the covenants of financing agreements. For example, designating an unrestricted subsidiary can set the stage for a drop-down transaction, where assets are moved from the credit group to the unrestricted subsidiary, which can then either leverage such assets as collateral for a new financing or dispose of such assets. Unrestricted subsidiaries can also be used in an exchange offer transaction, where the assets transferred to the unrestricted subsidiary are used as collateral securing newly issued indebtedness in exchange for existing junior secured or unsecured indebtedness of the restricted group.

The highly publicised case of J. Crew provides a notable example of a dropdown transaction. In 2017, the company used the flexibility contained in its 2014 credit agreement to make nearly unlimited investments in unrestricted subsidiaries. In doing so, J. Crew also transferred certain of its intellectual property to an unrestricted subsidiary – thereby removing the assets from the pool of collateral securing the company's existing debt. The unrestricted subsidiary then pledged the intellectual property as collateral for new indebtedness, the proceeds of which were used to repay certain of the company's existing debt. The company's creditors objected to the transaction, arguing that the transfer and debt incurrence were a violation of the financing agreement. J. Crew countered that the transaction was in strict compliance with the terms of its financing agreements and was designed to maximise the value of the company – a fact supported by trading levels for the company's debt. The dispute was ultimately resolved out of court, but not before garnering widespread attention from market participants.

In a similarly high-profile transaction, Claire's Stores Inc. transferred its intellectual property to a newly created unrestricted subsidiary and licensed the intellectual property back from the unrestricted subsidiary. The unrestricted subsidiary then used the unrestricted subsidiary to effectuate an exchange offer whereby indebtedness of the company was exchanged into indebtedness of the unrestricted subsidiary. The unrestricted subsidiary used the proceeds of the IP licensing agreement to service the new debt. Unlike the case of J. Crew, the Claire's Stores Inc.'s liability management transaction was not enough to rationalise the company's balance sheet and it eventually filed for bankruptcy.

As transactions such as these have become more common, creditors have exhibited a renewed focus on unrestricted subsidiary and intellectual property provisions in financing agreements. Many creditors are now seeking to limit the circumstances under which a debtor may create an unrestricted subsidiary, including by requiring that the debtor meet certain financial metrics at the time of designation. Creditors are also seeking to limit the flow of capital and other assets to and from unrestricted subsidiaries through clauses that restrict investments of intellectual property into unrestricted subsidiaries, remove the ability to distribute equity of unrestricted subsidiaries, cap investments in non-guarantor restricted subsidiaries, cap the amount of value that may be invested into an unrestricted subsidiary, limit which investment baskets may be used for purposes of making investments in unrestricted subsidiaries and limit the impact that distributions from unrestricted subsidiaries may have on financial covenant calculations (e.g., removing the ability to include debt-funded dividends from unrestricted subsidiaries in the calculation of EBITDA). Though creditors have had some success in implementing these restrictions, many financing agreements continue to clear the market without any such restrictions.

Release of Non-Wholly Owned Subsidiaries

Under most contemporary financing agreements, only wholly owned domestic subsidiaries are required to provide credit support for a debtor's obligations. However, many financing agreements also include provisions that automatically release a subsidiary from its guarantee and terminate liens on assets of such subsidiary in the event that the entity ceases to be wholly owned. Many debtors have taken advantage of these provisions by using the asset-sale and investment flexibility within financing agreements to convert a wholly owned subsidiary into a non-wholly owned subsidiary. Such a transition unencumbers assets which can then be used to facilitate a new financing.

This strategy was used by PetSmart Inc. when the retailer transferred a portion of its equity in the subsidiary holding its Chewy.com online business to its parent and a portion to an unrestricted subsidiary. PetSmart then requested that the agent under the financing agreement release Chewy from its guarantee and collateral obligations. PetSmart and its owners then intended to monetise the Chewy name by taking Chewy public.

PetSmart's creditors viewed the proposed transaction as controversial from the outset. Citibank, both the administrative and collateral agent under PetSmart's credit agreement, refused to execute the release documentation and resigned as agent. Creditors also objected to the transaction and PetSmart became embroiled in a legal battle over its permissibility. After a prolonged series of complaints, PetSmart ultimately reached an agreement with its creditors whereby its financing agreements were amended to permit the IPO of Chewy, but PetSmart was required to apply 100% of the net cash proceeds of the IPO attributable to the portion of the equity that was "impermissibly" transferred outside of the credit group to repay the indebtedness.

In the aftermath of the PetSmart/Chewy transaction, creditors have sought to clarify the circumstances under which an entity may be released from its guarantee and collateral obligations. Some creditors have sought to limit the automatic release from guarantee and collateral obligations to situations where a guarantor is no longer a restricted subsidiary rather than no longer a wholly owned subsidiary. Other creditors have sought to exclude from automatic release provisions transactions whose primary purpose is to release the entity from its financing agreement obligations. While creditors have not yet had success in introducing these provisions into financing agreements for portfolio companies of large-cap private equity sponsors, such provisions are becoming more common in the middle-market and for corporate borrowers.

Debt Repurchases

Many modern financing agreements allow a debtor to acquire its indebtedness on the open market on a non-*pro rata* basis. Doing so allows a debtor to opportunistically retire classes of indebtedness – and potentially to do so at less than face value. Such a transaction has the dual benefit of decreasing the company's debt burden and its interest expense, thus freeing up cash that the debtor can use to otherwise support its business. A debtor seeking to acquire its indebtedness on the open market should confirm that any such repurchase is in compliance with the restricted payment provisions contained in its financing agreements and consider the tax implications associated with potential cancellation of debt income attributable to such a transaction.

Such mechanics can be used in more bespoke transactions. Take, for example, iHeart Communications, Inc.'s 2016 liability management transaction. iHeart had a series of bonds with an upcoming maturity that were issued under a multi-series indenture.

The indenture provided that if the total principal amount of all bonds issued under such indenture fell below a certain threshold, a lien would automatically spring over the outstanding bonds, thus converting unsecured indebtedness into secured indebtedness. Rather than allow the near-term class of bonds to mature and trigger the springing lien, iHeart created a subsidiary that would acquire enough of the near-term class of bonds to ensure that the springing lien was not triggered and keep such bonds outstanding beyond the original maturity date. While structuring this transaction, iHeart steadfastly ensured that it strictly complied with its financing agreements and that its actions were beyond reproach by creating an independent board for the subsidiary and having a credible business justification for the transaction that was aimed at maximising the value of the enterprise.

By avoiding triggering the springing lien, iHeart was able to keep a large portion of its assets unencumbered and better position itself for a more comprehensive recapitalisation. While iHeart's actions were challenged in court by a group of aggrieved creditors, the court held that iHeart's actions were permitted under the indenture and that the springing lien had not been triggered.

Receivables Financings

Creative debtors facing liquidity shortages can also enter into a receivables financing transaction. Many financing agreements, particularly those for portfolio companies of private equity sponsors, include significant flexibility, allowing the debtor to enter into either on- or off-balance sheet receivables financing transactions. Under these provisions, a debtor may be able to isolate the company's highest quality and most liquid assets and use those assets to secure a new liquidity facility. In addition, the ability to enter into such a transaction will provide the debtor with leverage in negotiating with its existing creditors, who will be incentivised to retain such assets as part of their collateral pool.

Changes to Section 956 of the U.S. Tax Code

Under traditional domestic financing agreements, credit support was only provided by a debtor's wholly owned domestic subsidiaries and such entities were only required to pledge 65% of the equity of foreign subsidiaries. These limitations were designed to ensure that a debtor did not trigger a deemed dividend (i.e., phantom taxable income) under Section 956 of the U.S. Tax Code. In May 2019, the IRS published final regulations under Section 956, which made it possible for domestic debtors to pledge foreign assets without incurring adverse tax consequences. In light of such changes, a debtor should consider whether its unencumbered foreign assets can be pledged as collateral to help facilitate an exchange offer, refinancing, uptiering or other liability management transaction.

Since the change in law, creditors have sought to expand the guarantee and collateral requirements contained in financing agreements to include foreign entities, but thus far have not had success in doing so. Debtors considering a strategic transaction that involves the pledging of foreign assets should be sure to consider the local legal requirements for granting and perfecting a security interest in the foreign assets, as well as potential related liability for directors. Depending on the jurisdiction, compliance with those requirements can be costly and time-consuming.

Documenting Restrictions in Connection with a Liability Management Transaction

In the course of negotiating liability management transactions, it is common for creditors to seek to tighten the restrictions contained in existing financing agreements or to add new restrictions. Where the consenting creditors constitute the required voting majority, it is straightforward to make such modifications. However, if the consenting creditors do not constitute the required voting majority, both creditors and debtors need to think carefully about how such modifications are to be implemented. This situation frequently arises when a debtor is seeking a consent from its revolving lenders but not its term lenders – either because the debtor requires a modification to a financial covenant that is solely for the benefit of the revolving lenders or because it is in connection with an extension of the revolving credit facility.

If the new restrictions cannot be added to the financing agreement in the ordinary course, debtors can either add the needed new or modified restrictions to a provision of the financing agreement that can be amended without the consent of the non-consenting creditors (e.g., adding such restrictions to the financial covenant, if the financial covenant can be amended with solely the consent of the revolving lenders) or add such restrictions to the agreement governing the consent as conditions subsequent to the effectiveness of such consent. If the restriction is breached, then the amendment ceases to be valid and the debtor will often find itself in immediate default.

Conclusion

Like many aspects of today's credit markets, the toolkit available to debtors considering a liability management transaction is constantly evolving. Just as debtors continue to explore new and innovative techniques to execute liability management transactions, creditors will continue to seek to forestall known loopholes and close those loopholes yet to be exploited.

By their nature, liability management transactions are inherently controversial because they offer the possibility of disadvantaging one constituency to the benefit of another. As such, debtors and their advisors should keep three things in mind. First, they should ensure that their transactions strictly comply with the relevant terms of the financing agreements. If compliance requires the testing of financial calculations or determinations of value, it may be advisable to engage an independent financial advisor or rely on determinations of any independent directors. Second, debtors should follow best practices for corporate governance, including a properly documented and robust board process, and which may include the appointment of independent directors. Finally, debtors should ensure that the liability management transaction is designed in such a way that it will help preserve or maximise the value of the enterprise.

Over the coming years – and as we await a new stage of the economic cycle – we expect to continue to see debtors exploring both traditional and novel liability management transactions and creditors seeking to restrain financing agreements to limit the ability of creditors to engineer such transactions.

Endnotes

1. *See generally* Scott B. Selinger, Liability Management Tools, in Leveraged Financing 2019 (PLI Course Handbook Series Number B-2486, 2019), https://download.pli.edu/WebContent/chbs/254153/254153_Chapter05_Leveraged_Fin_2019.pdf.
2. Recently, direct lending, a more relationship-based lending arrangement, has increased in market share. It is too soon to conclude how that might impact covenants, especially since related transactions for the most part are at too early a stage to have needed to consider liability management transactions.
3. Assénagon Asset Management S.A. v. Irish Bank Resolution Corporation Limited (Formerly Anglo Irish Bank Corporation Limited) [2012] EWHC 2090 (Ch).

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

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For the past nine 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 230 private credit transactions closed by The Private Credit Group at Proskauer Rose LLP in 2019 and may not be indicative of overall market trends. Historical data reflected that, as the market became more competitive, the middle market experienced an influx of financing terms traditionally found only in large cap financings. The increased competition for deal origination during those years (due to a surplus of dry powder among lenders and a limited supply of attractive investment opportunities) resulted in the selective inclusion of certain large cap financing terms, albeit with a middle market orientation. In 2018, we saw a slowdown in this trend in light of uncertainty around the end of the current credit cycle. Data from 2019 evidences that large cap financing terms continued to appear in the middle market as well as demonstrates a slight uptick in the pace at which such terms is being assimilated as compared to what the data demonstrated in 2018. Middle market lenders continue to have a limited ability to unwind provisions that have been adopted. As such, we expect the influx of large cap financing terms to continue.

Large cap terms assume a profitable and durable business model and stable economic climate. Given continued uncertainty around the end of the current credit cycle, middle market lenders continue to react cautiously to the introduction of large cap terms with conditionality and risk mitigants. Although middle market lenders' appetite for certain of these large cap financing terms differ based on institutional biases, the inclusion of these large cap financing terms can be summarised by the size of the borrower's consolidated EBITDA. Our data reveals that, as a general matter, the inclusion of large cap terms becomes less prevalent as a borrower's consolidated EBITDA reduces. In addition, the inclusion of large cap terms with conditionality and provisions intended to mitigate inherent risks in such terms becomes more prevalent as a borrower's consolidated EBITDA reduces. 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 examine 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 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 2019

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 73% of our deals in 2019. Healthcare was the leading industry for transactions and accounted for 20% of deals, up from 15% in 2018. First lien, second lien and senior secured transactions increased for the year, whereas mezzanine loan transactions continue to decline in popularity falling to 3% of all deals in 2019 compared to 5% in 2018 and 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, 51.4% in 2018 and 71.4% in 2019. However, the impact to lenders of decreasing interest rate margins is partially offset by an increase in the LIBOR benchmark in recent years. With respect to commitment fees and OID, in 2019, 58% 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 2018 and 2017.

Closing leverage for middle market transactions in our data remains stable with only a slight increase from 5.20× in 2018 to 5.40× in 2019, with 72% of deals having a closing leverage between 4.00× and 6.99× (slightly lower than 78% of deals in 2018). Trends in closing leverage should also be considered against the backdrop of loosening of parameters relating to the calculation of consolidated EBITDA across the middle market, which effectively lowers closing leverage multiples and results in more forgiving financial covenants. In transactions with EBITDA greater than $50MM, only 29% 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, 63% of them had a cap on general non-recurring expenses (as compared to 28% and 70%, respectively, in 2018). In addition, addbacks for run-rate cost savings/synergies and restructuring costs have become more prevalent and negotiated caps may only apply to acquisitions and restructuring activities after the initial closing date of a financing.

Covenant lite deals, meaning deals that do not contain the usual protective covenants that benefit lenders, decreased in 2019 to 10% (from 18% in 2018) in deals with EBITDA greater than $50MM according to our data. However, we have seen an increase to 50% of deals with EBITDA greater than $50MM in our data of transactions that are covenant loose, meaning with financial covenant cushions equal to or greater than 40% against a borrower's model. Although financial covenants typically include a total leverage ratio test, 15% of our deals also included a fixed charge coverage ratio test which is down 18% from 2018. Of the transactions with financial covenants, 48% of them had five or more covenant step-downs (down from 67% in 2018) and of these transactions, 84% of them had EBITDA of less than $50MM.

The general trend towards borrowers' counsel controlling the drafting process at both the commitment papers stage and the definitive deal documentation stage continued in 2019. In most circumstances, the borrower will also select the precedent credit agreement to be used as a starting point for definitive deal documentation in a particular transaction. Frequently, the lender will not have participated in the prior transaction or the proposed precedent document will reflect a more upper market orientation than the current deal. As a result, and in light of frequently time-sensitive commitment periods and healthy competition for investment opportunities in the current market, lenders often agree to work with these proposed precedent credit agreements which often results in the lender accommodating terms that are more typically found in larger transactions.

Debt Incurrence

Flexibility for a borrower to incur significant additional debt facilities (both within and outside the applicable loan facility) was one of the most transformative structural changes to make its appearance in the middle market. Consistent with 2018, incremental facilities, incremental equivalent facilities, ratio debt and acquisition debt continue to be customary features of upper middle market and traditional middle market financings.

Incremental Facilities and Incremental Equivalent Facilities

An incremental facility (also commonly referred to as an "accordion") allows a borrower to incur additional term loans or revolving loan commitments under an existing credit agreement subject to certain limitations and conditions without the consent of the existing lenders. Incremental equivalent debt typically has the same features as an incremental facility except that the debt is incurred outside the existing credit documentation, either pursuant to a separate credit agreement 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 typically accommodate both incremental facilities and incremental equivalent facilities; (b) the traditional middle market will generally accommodate incremental facilities and is increasingly accommodating 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 sometimes include incremental facilities but generally do not provide for incremental equivalent facilities. Our data shows that 94% of traditional middle market deals include incremental facilities with 47% including both incremental facilities and incremental equivalent facilities, compared to 71% and 39%, respectively, from 2018.

Incremental Amount

- In large cap and upper middle market transactions, and increasingly in the traditional middle market, the existing credit facility will provide for an incremental facility with both (1) a fixed incurrence amount (known as a "starter basket" or "free and clear basket"), and (2) an unlimited incurrence amount, subject to compliance with one or more leverage ratios as further discussed below. 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 31.2% 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 15.8% from 2018. Depending on the structure of the original transaction (i.e. senior secured, first lien/second lien credit or senior/mezzanine) and what type of incremental debt is being incurred (i.e. debt *pari passu* to the senior secured, first lien or senior facility, debt that is junior to the senior secured, first lien or senior facility but *pari passu* with the second lien/mezzanine facility (if any), 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). The level of the ratios will often be set at the closing date leverage multiple or, in the case of unsecured debt, up to 1.00× outside the closing date leverage multiple in larger deals. In larger deals, there may also be an alternative test for the incurrence of incremental facilities used 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 (although the aforementioned alternative test for permitted acquisitions is not widely adopted).
- Data reveals a continuing trend in the traditional middle market to allow for both a starter basket and an unlimited amount, with 85% of traditional middle market deals in 2019 permitting both components of incremental facilities, compared to 79% in 2018. Financings in the traditional middle market historically required that the unlimited incurrence amount for incremental facilities be subject to *pro forma* compliance with the financial maintenance covenants as well as the standard incurrence leverage ratio test that we see today. Our data shows that the requirement that a borrower be in *pro forma* financial covenant compliance in order to use the unlimited incurrence amount has become rare. This protection may be less relevant from a lender's perspective as financial maintenance covenants loosen and are less likely to step down below the closing leverage level. Although no longer generally a feature of traditional middle market financings, in some instances in the lower middle market where incremental facilities are only permitted up to a fixed dollar amount (with no unlimited incurrence amount), the incurrence of incremental debt under the fixed cap will be subject to an incurrence leverage test (and less frequently, *pro forma* compliance with the financial maintenance covenants in addition to such leverage test). Borrowers now 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 leverage ratio for the incurrence of first lien debt, a senior secured leverage ratio for the incurrence of second lien debt and a total leverage ratio for the incurrence of unsecured debt). This approach allows a borrower to

incur a total amount of debt in excess of the overall total leverage test originally used as a leverage governor for all tranches of incremental facilities.

- For example, the indebtedness included in calculating a total leverage ratio would typically include all funded indebtedness of the applicable credit parties and those subsidiaries included in the consolidated 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 security interest 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, since the incurrence of first lien incremental facilities is governed by a first lien leverage ratio (rather than a total leverage ratio), that debt incurrence would not be prevented because the first lien leverage ratio does not include the unsecured indebtedness previously incurred by the borrower. However, if the incurrence of first lien incremental facilities was governed by a total leverage ratio, second debt incurrence would bust the total leverage ratio cap and be prohibited.

- This flexibility is provided in the upper middle market but is often rejected in 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, upper middle market and traditional 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 under the unlimited amount. These features allow a borrower to incur debt at any time (and from time to time) in an amount that exceeds (in the aggregate) the ratio-based cap by the fixed amount cap. In the instances where a traditional middle market financing allows for both a fixed starter basket and a ratio based unlimited incremental amount, middle market lenders historically required that the fixed amount be used first and did not permit reclassification, but that protection has substantially eroded as the reclassification concept continues to move 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 or term loan retired under the "yank-a-bank" provisions, an amount equal to the portion of such terminated commitments or retired loans; (b) in the case of an incremental facility that effectively replaces any term loans that were repurchased by the borrower and immediately cancelled, an amount equal to the portion of such repurchased and cancelled term loans; (c) in the case of an incremental facility that serves to effectively extend the maturity of an existing facility, an amount equal to the amount of loans and/or commitments, as applicable, under that existing facility to be replaced with such incremental facility; and (d) all voluntary prepayments of the existing term loans, previously incurred incremental term loans and incremental equivalent loans (limited in some cases in the smaller transactions to such loans that are *pari passu* to 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, and 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 pursuant to 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, the amounts will be limited to the voluntary prepayments of indebtedness or commitment reductions of the revolving facilities.

Rate and maturity

- Incremental term loans generally: (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 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 to the extent it is secured. 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 been adopted in the upper middle market. The traditional middle market does not contain significant variations, but more conservative deals sometimes only allow for the incurrence of incremental debt that is *pari passu* with the existing loans. Traditional middle market may also contain additional restrictions on greater than *pro rata* voluntary prepayments with the existing term loans (but not *pro rata* or less than *pro rata* voluntary prepayments) and will not permit earlier maturities of incremental loans. In some respects allowing a borrower to incur lien subordinated or unsecured incremental facilities instead of *pari passu* incremental facilities may benefit the existing lenders since those junior and unsecured lenders would not share on a priority basis in the proceeds of collateral in an enforcement scenario. Despite this, the traditional middle market often resists allowing different types of debt due to 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 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. This differential may be 75 basis points in large cap transactions. 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 (or incremental equivalent debt) with different payment and lien priorities has become commonplace in large cap and upper middle market transactions, borrowers typically push for provisions that 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 not any prior incremental loans), 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 date 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 basket incrementals as leveraged-based incrementals because borrowers are able to effectively reload the starter basket over and over (subject to sufficient capacity to redesignate borrowings to the ratio-based unlimited incurrence amount).

  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 (or the incremental equivalent 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 have had significant success maintaining the MFN provisions without a sunset. 2019 data shows that only 9% of traditional middle market deals with MFN provisions include a sunset period, consistent with 9% in 2018. Exceptions to the MFN provisions are generally only present in first lien transactions and senior stretch transactions where the credit is intended to be syndicated.

Use of proceeds

- In large cap, upper middle market and most traditional 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 some more conservative traditional middle market financings, all such uses of proceeds may be permitted, but subject to stricter leverage tests for purposes such as restricted payments (i.e. dividends) and payment of junior debt. Our data continues to show 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 and even the lower middle market in some cases. 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. In those lower middle market deals, the use of proceeds may be restricted to very specific purposes such as acquisitions or capital expenditures.

Ratio Debt

In addition to the incremental and incremental equivalent facilities described above, large cap and a growing number of 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 or any of its subsidiaries to incur additional indebtedness so long as the borrower meets the applicable leverage ratio (and subject to a cap on ratio debt incurred by subsidiaries that are not guarantors). An interest coverage ratio test may also be applied in place of a leverage ratio for unsecured ratio debt. If the ratio 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 or being unsecured. Additionally, where the traditional middle market allows for ratio debt, it requires that any applicable MFN provisions apply to any ratio debt that is *pari passu* to the credit facility obligations. Notably, this protection has migrated up market as upper middle market deals have increasingly adopted this protection in respect to ratio debt. Our data shows that 44% of traditional middle market deals permitted ratio debt, compared to 41% in 2018. Lower middle market transactions generally do not provide for ratio debt.

Acquisition Indebtedness

Credit agreements generally allow the borrower to incur certain indebtedness in connection with (and solely to fund) a permitted acquisition or investment. 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, but may also require that, after giving effect to the acquisition indebtedness, the borrower is in *pro forma* compliance with the financial covenants and/or meets a leverage test (typically the same test applicable to ratio debt). 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 solely to the extent it is subject to a dollar cap. Similar to the approach for ratio debt, where the traditional middle market allows for acquisition indebtedness, it requires that any applicable MFN provisions apply to any acquisition indebtedness that is *pari passu* to the existing credit facilities. Upper middle market deals have also increasingly adopted this protection in respect to acquisition debt.

Limited Condition Transactions

One of the best known outcomes of the loosened credit markets in 2005 was the introduction of the concept of "certain funds" or "limited conditionality" to US transactions by way of the transaction commonly referred to as "SunGard". This technology was proposed by sellers in order to give preference to those potential buyers who had financing locked down, although the certain funds concept frequently appeared prior to this in European transactions. "Certain funds provisions" align the conditionality of the commitment papers as closely as possible to the conditionality in an acquisition agreement in order to minimise the risk of a lender having a right not to fund upon the desired closing of an acquisition. Specifically, certain funds provisions (or 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. This assures 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, which is important for both sellers and buyers because a buyer is typically still responsible for funding the purchase price of an acquisition at closing even if its lender refuses to fund.

Acquisition financings in general, regardless of the market, have generally adopted SunGard provisions. The most typical formulation in upper market transactions, with respect to representations and warranties, are that the only representations and warranties required to be both made and accurate at closing are "specified representations" and certain representations in the acquisition agreement as described above. The other representations and warranties in the credit agreement that are deemed to be less material are not made at closing (so even if the other representations would not have been true, the borrower would not be in default immediately post-closing). In facilities with revolving loan features requiring a periodic re-making of these representations and warranties in connection with further borrowings, the lender receives the benefit of the full set of representations and warranties soon after closing. However, in financings without revolving loan features, these other representations and warranties may not be made in the future and would have limited utility to a lender. The upper middle market has generally followed the larger deals in this respect but not without objection, especially in transactions where lenders will not benefit from a regular bring down of the representations by way of the conditions precedent to borrowing under a revolver. In smaller or less competitive transactions, the other less material representations and warranties in the credit agreement will also be made at closing, but their truth and accuracy 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. 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. Certain funds is now applicable to the conditions to borrowing incremental facilities, incremental equivalent facilities and ratio debt in order to finance a limited condition acquisition. 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 such financing sources, 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 with features of limited conditionality. 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 and incremental equivalent 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 only 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.

Since 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 lower middle market and traditional 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. This application of the leverage test is often seen in the traditional middle market and upper middle market (but less frequently). Another compromise is to test all maintenance financial covenants and incurrence leverage tests on both a *pro forma* and stand-alone basis.

Available Amount Basket

Once the leveraged financing markets revived following the down turn of the financial markets in 2008–2009, the concept of the "available amount basket" seen in high-yield bond deals migrated into, and became prevalent in, the upper and traditional middle markets. However, 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 that generally restrict cash outflow (i.e. investments, dividends, payment of junior indebtedness and in some upper market deals, this concept even extends to debt incurrence) without asking for a consent from the lender to the extent a borrower has built up capacity of the available amount by increasing in profitability and taking other actions that are considered accretive to the business.

Lenders are willing to permit this increase in certain baskets in the negative covenants as an attempt to recognise and reward the borrower for increased profitability and for taking such accretive actions. In some cases, lenders construct the conditions to a borrower using the available amount to incentivise deleveraging, which lenders also view as positive event. Our data shows that 91% of traditional middle market deals include the available amount basket concept, compared to 76% in 2018.

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") generally determined on a case-by-case basis (which amount may be further increased by a grower basket in the larger deals). Unlike the incremental starter basket, this is not necessarily based on a percentage of the borrower's EBITDA. The starter basket amount is often 25%–50% of the borrower's EBITDA but can reach 100% of EBITDA in larger transactions. The available amount basket in upper and traditional middle market transactions (but less frequently in the lower middle market) will often include a starter basket amount. Our data shows that 92% of traditional middle market deals with the available amount basket include a starter basket amount, compared to 85% in 2018.
- *Retained Excess Cash Flow or a Percentage of Consolidated Net Income*: typically in upper market deals, the available amount basket will include a percentage of consolidated net income or retained excess cash flow, at the borrower's election. This is preferable for a borrower because it will have quicker access to the consolidated net income (while excess cash flow often won't be recognised until after the first full fiscal year following the closing date). 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. 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. Traditional middle market deals generally include such returns only to the extent they are in cash or cash equivalents, or limit this prong to returns on investments made using the available amount basket.
- *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 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 (but not investments) and such conditions may include no payment or bankruptcy events of default as well as a specific leverage test set within the closing date leverage level (or at the closing date leverage level in larger deals). In a growing number of cases, the leverage test will apply only to the retained excess cash flow or percentage of consolidated net income component of the available amount basket (and sometimes to the starter basket amount as well). 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 include a no event of default condition and *pro forma* compliance with a leverage ratio test (which, with respect to the payment of dividends or junior debt, is often well within the closing date leverage (by as much as 0.5× to 1.5×)).

Grower Baskets

Akin to the available amount basket, a "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 71% of traditional middle market deals include grower baskets in some form, compared to 54% in 2018.

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 that corresponds to that dollar amount as of the closing date of a transaction. Grower baskets are commonly thought of as exceptions to negative covenants, but are also used in connection with the free and clear amount in incremental debt and incremental debt provisions and the starter basket amount of the available amount basket as described above. In the traditional middle market (and to a lesser extent the upper middle market), 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).

Rather than being structured as a stand-alone basket (like the available amount basket), grower basket describes the concept of adding of a growth component to a fixed dollar basket based on a percentage of EBITDA or consolidated total assets so that growth of that particular basket 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 and the value of assets is not always indicative of profitability. Additionally, 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 on a case-by-case basis.

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 (with the hard capped amount operating as a floor). 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 continues to show 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 2019, our data demonstrated an uptick in the pace of adoption as compared to 2018 (with the pace of adoption slowing in 2018 in the midst of a global economic slowdown, declining stock markets and speculation regarding the upcoming end of the current credit cycle). Momentum has historically been 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. 2020 began with a record-long economic expansion. Many economists anticipate modest growth, but also warn of fragility and remain watchful for an impending contraction. Our data shows that events of default under active deals (i.e. deals closed by Proskauer that remained active in 2019) remained low in 2019, at around 3% of all active deals. However, lenders are likely to remain cautious about their existing portfolios in the face of this risk and be more selective with respect to investment opportunities and, to some extent, legal documentation. Despite these risks, lender interest in private credit as an asset class remains strong. Although the state of the economy remains uncertain, we expect a sustained migration of large cap terms into middle market transactions. This is expected to continue to occur to varying degrees based on the dividing lines of the lower middle market, traditional middle market and upper middle market. However, lenders continue to achieved some success in flexing out more aggressive formulations of these terms during primary syndications of transactions (although to a lesser extent than in 2018). Our data continues to show that lenders' ability to unwind large cap concepts and provisions from credit documents is, for the most part, limited. As noted above, the continuing trend of borrowers and middle market lenders using credit documents from prior transactions (or precedents with an upper market orientation selected by a borrower) as the basis for the documentation of a new transaction should also continue to drive the adoption of upper market concepts and provisions into smaller transactions.

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Driving Innovation: New Opportunities for Law Firms to Partner with Global Clients in Cross-Border Projects


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I Introduction – Growth of Cross-Border Finance Creates New Opportunities for Law Firms to Advise Global Clients

The continuing increase in cross-border finance, together with recent advances in legal technology, create new opportunities for global law firms to offer valuable legal advice to global institutional clients. Much has been written about cross-border loan activity in terms of number of transactions, number of participating jurisdictions and complexities of navigating conflicting laws across multiple jurisdictions. This changing landscape creates new challenges for in-house counsel at global financial institutions who must consider legal risks relating to a borrower's or guarantor's jurisdiction, as well as other legal risk factors traditionally considered in domestic loan transactions. As a result of the increase in cross-border finance activity, in-house counsel are increasingly reliant on foreign local counsel expertise in a growing number of jurisdictions.

In-house legal teams at global financial institutions are traditionally staffed with senior lawyers at headquarters, hub sites and satellite offices who are licensed to practise in the home jurisdictions where their local offices are located. They frequently collaborate with colleagues in foreign offices who serve as a resource for routine local law inquiries on a deal-by-deal basis, providing guidance with respect to perfection of security interests, enforceability of cross-border guarantees, market practice, and basic corporate formalities. However, in this cost-conscious environment, in-house legal teams are typically thinly staffed and outside counsel is often consulted for more complex foreign law guidance.

In addition to the increase in cross-border transactional volume, there has also been a recent increase in large-scale complex regulatory and legal initiatives, as well as the introduction of new technology for legal innovation. Together, these factors also create new multi-jurisdictional legal challenges. For example, as a result of the UK's exit from the EU, global banks headquartered in the United Kingdom will no longer have the benefit of an EEA passport and will have to consider local law licensing restrictions before lending to EU-European borrowers. New developments in technology also create multi-jurisdictional challenges for lawyers working on cross-border transactions. For example, banks are increasingly looking to use e-signature for commercial lending transactions to speed up closing times and improve customer experience. If the jurisdiction of the documents' governing law is different from the jurisdiction of formation of the borrowers and guarantors, the laws of each jurisdiction will have to be considered. Although most modern business jurisdictions have adopted some form of e-signature legislation or regulation, there is no uniform global framework and laws vary significantly across borders and regions.

In this changing legal, regulatory and technological landscape, law firms with a multi-jurisdictional footprint are well placed to provide foreign law guidance across geographies to global clients both on a transaction-by-transaction basis, and for large-scale legal and regulatory initiatives. In addition to providing traditional legal guidance, some global law firms are increasingly using new technology to collect legal data across different jurisdictions and develop digital tools for lawyer clients to access this information more efficiently. Recognising that in-house legal departments are under increasing cost pressures and are increasingly asked to do more with less, some law firms are also partnering with in-house lawyers to develop business self-service digital tools, programming AI to sift through a huge volume of legal data to provide simple yes/no answers to key questions business clients frequently ask in-house lawyers in order to progress transactions.

Following are two examples of current large-scale legal and regulatory initiatives and opportunities they create for law firms to use legal technology and multi-jurisdictional expertise to expand the services offered to legal and business clients.

II First Example – Cross-Border Licensing

The first example deals with a multi-jurisdictional project that started its life with an unassuming question but eventually morphed into a long-term, fully blown global project that led to the development of a cross-border licensing app covering some 90 banking products in over 50 jurisdictions.

When discussing the possibility of a US affiliate of the bank joining a syndicate of lenders in a financing that included French borrowers, the French Banking Monopoly (art. L511-5 '*Code monétaire et financier*' (French Monetary and Financial Code)) was raised as a potential obstacle to the US affiliate joining.

At the time the French banking monopoly rules (since somewhat reformed) prohibited the provision of regular 'banking activities' in France, unless the entity carrying out those activities was either a licensed credit institution or financing company in France or 'EEA passported' (i.e. under EU Directive 2000/12/EC) to provide banking services in France. The scope of 'banking activities' is wide and includes all common forms of lending.

While this was not news to the bank as an organisation, some individual colleagues were less familiar with licensing requirements as a potential barrier to cross-border business. This raised some questions.

Do other jurisdictions apply similar cross-border restrictions?

Do restrictions apply to lending only? What about other products, such as guarantee issuance, cash management and custody services?

The answer, of course, is that other jurisdictions do restrict lending activities in their jurisdiction and that restrictions also exist in relation to other financial services.

The following may help internal counsel to consider potential cross-border licensing restrictions in a structured way and help external counsel to consider how to support banks and their in-house counsel with similar projects.

What is cross-border licensing?

Technically, cross-border licensing regulation is rare. With few exceptions, cross-border licensing rules are simply the rules that apply in a jurisdiction to regulate the provision of financial services to individuals and corporate entities based in that jurisdiction. Where a financial institution in country A wants to lend to a customer in country B, it may not be sufficient to be licensed in country A. Additionally, local rules or restrictions may also apply to lending in country B.

What is it not?

At least for the purpose of this chapter, cross-border licensing is not concerned with matters such as local execution formalities, exchange controls, sanctions or the potential tax impact of providing financial services across borders. All these things are important of course and must be considered, but they only matter if it is permitted to carry out the relevant activity in the first place.

It is also worth mentioning that cross-border licensing is not merely concerned with cross-border marketing. Cross-border licensing rules are frequently taken to be rules on cross-border marketing and, in the same vein, cross-border business is often referred to as cross-border marketing. This is understandable perhaps because it is counter-intuitive that the marketing of a service should be permitted while the sale of the same service should be prohibited. This is, however, to assume that licensing rules always 'make sense' and it ignores the fact that marketing is just the first step of a cross-border transaction. Marketing is often missing entirely from transactions where, for example, the bank is approached by the borrower, and not all jurisdictions treat a customer's 'reverse solicitation' as an exception to a general licensing requirement.

This makes it crucial to consider the whole lifecycle of a transaction, starting with a deal's inception (first contact, who contacted whom and how?) and covering both execution as well as the provision of the product itself.

Why does this matter?

The consequences of a breach of licensing rules can be severe. They vary from civil penalties in some jurisdictions to criminal offences that can lead to imprisonment in others. Transactions entered into in breach of local rules may be declared null and void and local affiliates of the financial institution in breach could face a loss of their banking licence. In short, a breach of licensing rules and restrictions should be avoided at all costs.

No uniform legal framework

Rather impractically for international banks, there is no uniform legal framework on cross-border lending and instead cross-border activities are governed by a complex set of laws and regulations that vary considerably between jurisdictions.

This is also the case between the different Member States of the European Union, but the majority of banks operating from and within the EU rely on 'EEA passporting', which allows financial institutions authorised in their home jurisdiction to carry out the activities for which they are authorised in their home state and any other EEA state, on a cross-border basis.

For UK incorporated financial institutions, cross-border licensing requirements suddenly became very topical with the 2016 referendum on the United Kingdom's membership in the European Union. The implementation period that followed the end of the UK's EU membership (during which EU rules continue to apply) will end on 31 December 2020. That means that unless the UK and the EU come to a different agreement in relation to the provision of financial services in the meantime, UK banks will be treated the same as any other non-EU financial institution.

The project – practicalities

The French Banking Monopoly discussion triggered a wider debate around the various other jurisdictions in which the bank operates and on products other than lending. An external assessment of the bank's cross-border business model was conducted with a view to making sure that the bank and its subsidiaries operate in compliance with local regulations.

The bank's review found that while the bank had access to a large volume of cross-border regulatory information and had successfully implemented policies and procedures in relation thereto, some business divisions and jurisdictions had also independently sought repetitive advice and implemented procedures tailored to specific products or jurisdictions that were not always needed.

Not all of the information available to the bank was also easily accessible to front-line businesses. Instead, legal and/or regulatory compliance departments often had to be contacted or voluminous country guidance documents consulted. This was inefficient and costly. Improving access to the information would ensure the risks were always identified where they existed and that the correct decisions were made.

To manage this risk appropriately and in the most practical and cost-effective way, the bank initiated a project to implement a new, generic approach to cross-border business risk management across the bank. The main aim of the project was to align existing information across jurisdictions and business lines, to determine applicable laws and regulation to the extent that there were any gaps and, most importantly, to provide the business with brief, straightforward guidance on licensing requirements.

Initial attempts to refresh and simplify existing country guidance documents quickly made it clear that the result of those attempts (often approaching telephone directory size) could not be shared with the business. Instead, a new way had to be found to establish global consistency in the interpretation and application of cross-border licensing rules and to provide quick access to understandable guidance for front line business colleagues.

There are existing online resources and some very good products are available from international firms that provide comprehensive guidance. For the bank they were either somewhat unwieldy on the technology side (e.g. large tables of very detailed information) or they did not sufficiently match the bank's global product offering. We also found that firms that provide excellent sources of information regarding markets regulation sometimes provided less comprehensive information on traditional banking products and *vice versa*.

The bank decided to look for a bespoke solution that would satisfy regulatory requirements while still being 'nimble' enough to provide quick practical help to front line business users. The new goal was therefore to create an app. In addition to the characteristics mentioned above, the advantage of an app was that it would be able to create an audit trail of enquiries for governance, management information and policy assurance purposes.

However, for the app to provide 'quick and easy' answers, it needed to be underpinned with a solid foundation of more comprehensive licensing information. This would also allow the legal and regulatory compliance functions to carry out more detailed reviews of transactions or new products and to trace each answer provided by the app back to its regulatory source.

The app also had to cover some 90 products in over 50 jurisdictions and, for each of these, needed to be able to distinguish between three possible methods of contact between bank and client. This meant that the app would have to manage information on over 13,000 different scenarios.

This was complex from a technological perspective. Suffice to say that the project did not immediately come up with a *grand design* that solved all problems it encountered along the way.

The app was produced in cooperation with a software company and now provides very quick answers in all straight-forward cases. It also provides practical guidance on how to carry out cross-border transactions where conditions or restrictions apply and connects users with local (internal) specialists where a more detailed discussion is necessary. The app (and the information it relies on) is regularly updated and provides automatic updates to its users where regulatory change is material enough that it would change the answer to a previous query.

Some of the obstacles that had to be overcome on the regulatory side of the project (the technology side is not subject of this article) are worth looking at in more detail, if only to allow others to safely circumnavigate them.

Where to take the information from?

Agreeing the general structure of the app was a crucial step but also only the first of many. That structure now had to be filled with answers which again would be based on vast amounts of information that had to be assessed for each product in each jurisdiction so that the app would be able to say 'yes', 'no' or 'yes, subject to the following conditions…'.

For regulatory information and analysis on the various jurisdictions and products we contacted, several international law firms through a request for proposal process and awarded the contract to a firm that had already done a considerable amount of work on the topic and was offering an 'off the shelf' product that covered a lot of ground.

The scope of the firm's appointment and fees were agreed but it is probably fair to say that neither party knew exactly how that scope would evolve over time. Sometimes the way in which the bank provided products and services or a specific licensing regulation meant that the app's structure had to be adjusted. At other times it was the other way around and restrictions in the app's technology forced the project to consider a different approach to making the advice available.

As with any large, evolving project, this is where transparency and trust between internal and external counsel is crucial. The temptation to win a deal with a fee estimate that is slightly lower than it ought to be and maybe based on the hopeful assumption that no forks in the road will be encountered is very understandable. However, it creates a real headache for any internal counsel to be told, mid-way through a project, that the initial quote was off the mark and has to be adjusted.

Equally, in-house counsel appointing external firms need to acknowledge that twists and turns along the road or client-side delays can create considerable extra work, even without technically changing the scope of the firm's appointment.

Interpreting licensing regulation

In theory it is not difficult to compile a list of licensing rules and restrictions in any given jurisdiction. In practice this is quite a different matter if that information is to be applied in earnest and not just to gather dust as a grand compendium of 'foreign' licensing laws.

Licensing regulation needs to be interpreted for each banking product in relation to the way it is provided by the bank. This is not straightforward because regulation does not always directly 'translate' into the services provided by a bank. In many cases, bank services are a combination of regulated and unregulated activities or are made available to customers in a way that does not quite match the characteristics of the activity as defined in regulation. To ascertain if a product may be made available on a cross-border basis, it needs to be dismantled into its component parts.

Even within a lending context, this can be challenging. Take overdraft facilities, for example. Most jurisdictions that regulate lending will consider an overdraft to be lending. One might therefore conclude that a foreign financial institution may provide overdraft facilities, provided it satisfies all conditions that apply to a loan.

While that is not by itself incorrect, it misses the fact that, by definition, an overdraft is credit made available on a bank account. The opening and maintenance of a bank account involves deposit-taking and it will also involve the payment services. From a regulatory, licensing perspective this means that an overdraft consists of deposit-taking, payment services and lending. In some jurisdictions, each one of these activities is regulated, and in others, only some (while a few do not regulate any of these activities).

Other bank products pose similar challenges. Trade services (e.g. guarantee/LC issuance) may or may not be regulated in any given jurisdiction (in many they are considered a form of lending/credit) but will frequently also involve the opening of a cash account and, therefore, deposit-taking and payment services. Similarly, custody services will frequently involve a bundle of regulated and unregulated activities or include customer bespoke arrangements that will need to be considered in detail.

The interpretation of regulation and matching of local rules to bespoke banking products was probably where our partnership with the external law firm proved most valuable. There are various examples in addition to the 'bundling' issue above where the firm's expertise and experience with similar projects was invaluable.

How, for example, should 'market practices' be dealt with? When is reverse solicitation not really reverse solicitation and how should it be evidenced? Where 'volume restrictions' apply, how many loans are permitted? Does the bank really need a local licence just because its name contains the word 'bank' (despite the fact that the activity itself is unregulated)?

In cases where the bank's existing views on local licensing requirements were substantially different to the advice received from external counsel, the project either had to find common ground or make a further analysis to determine which approach was the most appropriate. In the (much rarer) latter case, this had to be explained and recorded for future reviews of the bank's cross-border business framework. From the firm's perspective, it was important that the advice provided by the app (on the basis of the bank's view) would not be misidentified with the firm's undiluted initial advice.

Luckily, real differences of opinion were very rare and mainly attributable to a difference in risk appetite where regulation was either vague and open to interpretation, or where it was overlaid by market practices.

How to analyse a cross-border transaction

There is a logical line of inquiry which, if followed, can be quite helpful when considering cross-border licensing requirements.

Is the activity regulated?

The first question is whether or not the service/product to be provided across borders is an activity for which licensing laws or regulation exist in the customer's jurisdiction and (if different) in the jurisdiction in which the service is to be provided. As discussed earlier, there is not always an easy answer but there is a surprising number of jurisdictions in which lending, for example, is not a regulated activity.

Even if an activity is regulated in principle, it is worth checking if the local regulator would consider it as falling into the territorial scope of its jurisdiction. What about branches of foreign entities, for example, that use banking services in the home jurisdiction of the financial institution?

Territorial scope

In the same way that licensing regulation is not unified across jurisdictions, the scope of licensing rules also differs widely.

Some regulators consider the provision of financial services to a corporate entity (or an individual) based in the regulator's home jurisdiction to be subject to local licensing requirements, even if the service itself is provided outside that jurisdiction. Other jurisdictions define the territorial scope of their licensing rules less widely and will treat activities as falling outside the territorial scope of local laws and regulation if certain parameters are met.

France is an example of the latter case and whether French licensing rules apply depends on the circumstances of the relevant case. Using the example of an overdraft as a 'bundle' of regulated activities again, factors to look at when establishing the scope of French banking rules are (amongst others): whether the service was marketed to French customers in France; where documentation is executed; what the governing law of documentation related to the service is; and whether payments are made into or out of a French bank account.

The scope of German licensing rules is quite different. Again, in relation to bank accounts and overdrafts, German banking regulation treats services provided to a customer incorporated in Germany as being provided in Germany, even if the account in question is located elsewhere. A comment made frequently when working through this aspect with stakeholders was that "*surely it can't have been the German, Dutch [other] regulator's intention to cut domestic companies off from international money markets*".

That is probably true. However, the fact that regulation applies does not necessarily mean that the activity is not permitted. It also overlooks the possibility that some activities may appear prohibited but are tacitly (sometimes explicitly) tolerated. Finally, licensing regulation is primarily aimed at setting the rules for the local financial market and not necessarily at prohibiting cross-border business. It is entirely possible that, in some respects, cross-border business was not considered principally when local licensing requirements were implemented.

Exceptions to the rule

Once it has been established that (a) the transaction or product does contain one or more regulated activities which (b) fall into the territorial jurisdiction of the regulation, there may still be exceptions to the rule.

It would exceed the confines of this chapter to list all typical exceptions and exemptions to licensing requirements or to describe them in any detail. Again, different jurisdictions apply very different rules (and exceptions). However, there does seem to be a certain pattern of exceptions and exemptions in most jurisdictions that is worth exploring.

For example, many general prohibitions (i.e. "*don't do it, unless you're licensed here*") apply in respect of certain customer types only or seek to restrict activities by certain types of financial institutions only. EEA passporting will obviously continue to be available to EEA licensed banks and sometimes licensing requirements do not apply if the transaction was initiated by the customer (reverse solicitation).

This is where working with a well-connected international law firm can provide most value. A firm with expertise in regulatory matters will have considered the majority of scenarios before and will find it easier to apply solutions to bank-specific services or it may be able to approach the local regulator for views directly. This is not to say that advice from regional or local firms with regulatory expertise would be less valuable. After all, most international firms will still seek help from local firms. However, if a bank needs regulatory advice from a large number of jurisdictions, it may just be easier to work with a firm that coordinates that exercise for you.

Cross-border licensing decision tree

The 'line of inquiry' mentioned earlier can be summarised in a four step decision tree as follows.

1. *Is the activity regulated in the customer's jurisdiction (or, if different, the jurisdiction in which the bank intends to offer the service)?*
   If it is not, the transaction does not trigger a local licence requirement.
   If it is, go to the next question.

2. *Does the activity take place in the customer's jurisdiction (or jurisdiction in which the bank intends to offer the service) or is it deemed to be taking place there?*
   If it does not, the transaction does not trigger a local licence requirement.
   If it does, go to the next question.

3. *Do exceptions to or exemptions from any general licence requirements exist?*
   If not, the transaction should <u>not</u> go ahead without a local licence.
   If exemptions exist, go to the last question.

4. *Does the exception/exemption apply to the specifics of the case?*
   If it does, the transaction does not trigger a local licence requirement.
   If it does not, the transaction should not go ahead without a local licence.

This is obviously not the panacea to all licensing concerns (and it ignores any other restrictions and requirements not related to licensing that may apply) but it may provide a structure to consider when addressing them.

III E-signature Risks in Commercial Cross-Border Lending

E-signature is another example of a large-scale legal or regulatory initiative that creates complex cross-border challenges for in-house lawyers. Financial institutions are eager to adopt digital strategies that will allow them to service clients' needs faster and more efficiently while reducing costs. Replacing wet ink signatures with digital paperless processes to execute loan documents can save time and money for both banks and customers by reducing document handling time and costs, as well as the need to re-execute documents during and after closings to correct mistakes made when first signing and dating documentation.

Most countries with established lending markets have enacted legislation defining the requirements for enforceability of e-signed contracts indicating local support for technological innovation and creating certainty for domestic transactions. However, there is little harmony across jurisdictions in terms of specific local requirements and market acceptance of e-signed lending agreements. Legal requirements vary across geographic boundaries and regions for e-signed loan documents to have the same level of enforceability as wet ink signed loan documents where the signature typically has the presumption of validity and the burden of proof is on the challenger to disprove the validity. Market acceptance by banks, courts and local collateral registries is also inconsistent globally. This lack of uniformity is significant for commercial cross-border lending transactions where the jurisdiction of the documents' governing law, as well as the jurisdiction of formation for each borrower and guarantor, must be taken into account in order to avoid potential challenges to enforceability by borrowers or guarantors under the applicable local law of their jurisdiction of formation in addition to the jurisdiction of the documents' governing law.

The lack of a consistent global approach towards the use of e-signature in commercial lending documents creates legal risks for banks engaged in cross-border lending that must be weighed against the benefits of using new technology to streamline processes and delivery, improve customer experience and reduce internal costs. These legal risks are increased for global banks with active footprints in international markets with extensive cross-border activity, such as in the financial centres of London, Hong Kong and New York, and are highlighted by looking at a hypothetical commercial cross-border loan transaction. In this example, a US bank makes a loan to a corporate borrower organised under the laws of an EU member country and guaranteed by a parent company organised under the laws of England and Wales. The loan documents are governed by New York law.

If the parties to this hypothetical transaction want to use e-signature to execute the loan documents, the bank must consider the laws of three countries, in addition to EU regulation, in order to assess the legal risks of using e-signature for this deal. The bank would first look at New York law, which governs the documents. As a general rule, under US federal and state law (Electronic Signatures in Global and National Commerce Act 2000 (ESIGN); Uniform Electronic Transactions Act (recommended to states 1999) (UETA)), e-signature is broadly recognised as having the same legal effect as wet ink signature so long as the transacting parties have consented to its use and all legal requirements for a contract are met; there are no specific technical requirements for e-signature to have the same legal effect as wet ink signature.

Next, the bank would look to both EU regulation and also to the specific laws governing e-signature in the borrower's local jurisdiction within the EU. In order to create certainty among member countries regarding the cross-border use of e-signature, EU regulation (Regulation (EU) No. 010/2014 (eIDAS Regulation)) provides that among EU member countries, e-signature cannot be denied legal effect simply because it is in electronic form. However, in order for e-signature to have the same legal effect as wet ink signature, it must meet the heightened technical requirements of a 'qualified electronic signature'. These requirements focus on verifying the identity and authenticity of the signer, requiring, among other things, that the applicable e-signature is created using a 'qualified electronic signature creation device', such as an approved token, and certified by a 'qualified trust service provider', a vendor selected from a pre-approved list.

Outside certain regulated industries where qualified electronic signatures are widely used, many corporate borrowers formed in EU member counties may determine that complying with the technical standards of qualified electronic signature is impractical or overly burdensome for borrowing transactions. Banks lending to EU borrowers may have to weigh the efficiency benefits of offering e-signature against the risk of accepting a version of e-signature that is less onerous than "qualified e-signature", in which case the e-signature could carry less evidentiary value than traditional wet ink signature if enforceability is subsequently challenged by a counterparty and the burden of proof could shift to the bank to prove the validity of the e-signed agreement.

In addition to EU regulation, the parties would look to local regulation in the jurisdiction of the borrower's formation. Under the EU regulation, member countries are permitted to enact more liberal e-signature laws but are not permitted to enact laws that are more stringent than the EU e-signature regulations.

Last, the bank would also look at e-signature laws in the guarantor's jurisdiction, in this case England, which, prior to its exit from the EU earlier this year, had adopted a more liberal approach to e-signature than under EU regulation. As a general rule, under English law through a combination of legislation, case law and common law principles (Electronic Communications Act 2000 (ECA 2000)); see Law Society/CLLS e-signing guidance note (published 25 July 2016)), e-signature is broadly recognised as having the same legal effect as wet ink signature without specific technical requirements, so long as the transacting parties intend to authenticate the document and have adhered to all formalities relating to execution. However, some agreements, such as security documents and corporate guarantees, are drafted to be executed as a deed, frequently requiring a witness to be in the physical presence of the signer when the deed is executed. Because English law does not permit remote witnessing of e-signed documents, when such parent guarantees are e-signed, the witness and the e-signer must be in each other's physical presence, making it impractical to comply with the formalities required for enforceability in such cases.

Additional legal risks may arise in the case of secured transactions as many local registries globally do not accept e-signed collateral documents for registration, even in jurisdictions that recognise the enforceability of e-signature. For example, although US laws broadly recognise e-signature as having the same legal effect as wet ink signature, market practice among real estate registries varies on a state-by-state basis and some local registries refuse to perfect security interests evidenced by e-signed mortgages or deeds of trust. If that situation occurs, an e-signed mortgage or deed of trust would be enforceable only between the transaction parties but not against third party challenge.

To further complicate the global landscape, some jurisdictions have enacted local legislation specifically carving out loan agreements as a class of documents from the list of approved documents for which e-signature is enforceable. In other jurisdictions where legislation recognises the enforceability of e-signed commercial lending documents, judicial practice sometimes takes a contrary approach and courts have a history of rejecting e-signed agreements, exposing banks to additional risk if enforceability is challenged.

Managing e-signature legal risk across multiple jurisdictions

In order to implement e-signature while effectively managing the legal risks arising in cross-border lending transactions across jurisdictions with inconsistent laws, regulations and practices, banks will want to rely on a resource that provides straightforward guidance on a country-by-country basis, taking into account 1) whether e-signature for commercial lending documents is enforceable in the jurisdiction of governing law and the borrower's and the guarantor's jurisdiction of formation with the same presumption of validity as wet ink signature, 2) if there are any technical or formal requirements, 3) market and judicial acceptance, and 4) if the loan is secured, whether local registries will accept the applicable e-signed agreements for perfection. Ideally, such a resource should be developed for business use to enable a well-informed risk-based decision to be made quickly and efficiently by the front line. Due to the complexity and volume of the legal data that must be sifted through in order for a "yes" or "no" decision to be made, manual tools in table format can be difficult to navigate and interpret and often require front line business teams to contact legal or compliance for additional advice, adding time to the closing process.

Like the app described above that was developed for cross-border licensing, an ideal resource could be an app or online product that is programmed to quickly provide clear and reliable guidance to business teams in user-friendly form and create an audit trail of enquiries made for governance, management information and policy assurance purposes. Global law firms, with their in-depth knowledge of legal requirements and market practices across multiple jurisdictions, are well placed to provide the extensive data needed to develop this product.

IV Conclusion

Both the cross-border licensing app and the e-signature initiative are examples of large regulatory projects that are most successfully tackled through a cooperation between in-house lawyers and external counsel.

Handing projects like these over to external counsel in their entirety may be tempting but is unlikely to produce the desired results because the proposed solution would likely lack the practical organisational knowledge necessary to address the specific needs of the client. Similarly, a pure in-house effort would take too long, tying up internal legal resources in the process.

The issue of banking products consisting of more than one regulated activity is a good example of an area where a combination of the bank's in-house counsel's familiarity with the product combined with external counsel's subject matter expertise lead to a very practical solution.

Future projects like these will inevitably benefit from the various digital solutions currently being developed by law firms. The more adaptable they are to cater for the specific requirements of the firms' clients, the more successful they will be.

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Trade Finance on the Blockchain: 2020 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 digitizing the global trade engine. 2019 saw several industry participants move from pilot programs to efforts on commercial projects. 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 analyzing 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, utilizing 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

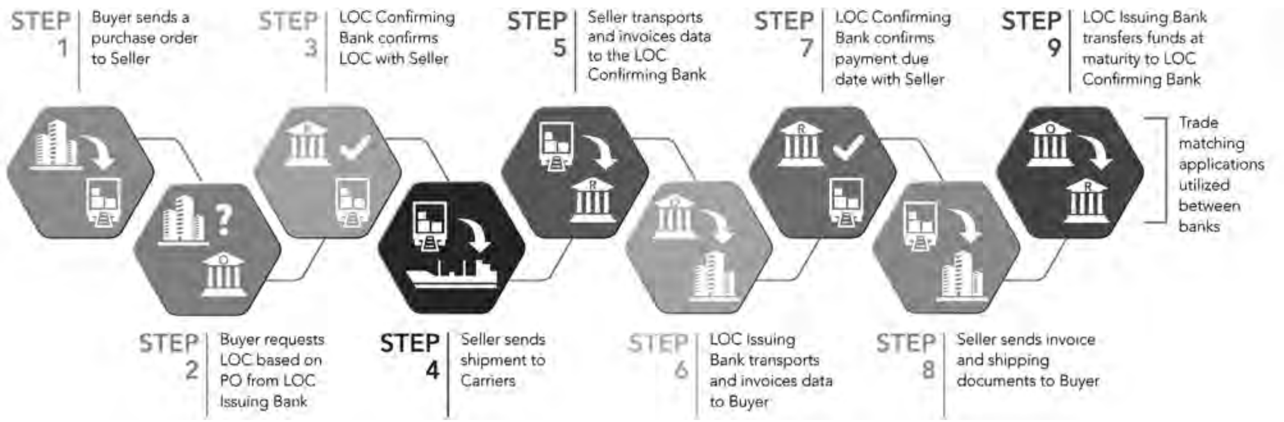
Before discussing the future of trade finance, it's important to understand the current mechanisms used to facilitate the movement of goods and commodities across the globe—much of which has remained static over the last few hundred years. It did not take human civilization long to discover the benefits of specialization 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 fertilizer 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 fertilizer 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 cannot analyze 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 collateralized (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 utilizes 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 memorialized 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. 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) Multichain; (4) Ethereum (permissioned version, Quorum, developed by JPMorgan); and (5) EOS.

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 is growing exponentially—both in terms of consumer and industrial products. For example, in January of 2020, BMW and DHL established 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 transparency to the supply chain of auto parts distributed globally from Malaysia. The joint venture will provide a dashboard that will allow users to monitor data, in real-time via IoT devices, from placed orders, orders in transit and delivered orders.[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 analyze that data and send commands back to physical devices to interact with the physical world. For example, if the security seal (an IoT device) on a DHL storage container is broken prematurely before the delivery date, that data will trigger an application monitoring that information over the Internet to send a signal back to the container's locks to automatically clamp shut until further instruction.

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 authorized user can authorize the dispatch or acceptance of a 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, in Q3 of 2019, the Mobility Open Blockchain Initiative ("MOBI") and five major auto manufacturers, Ford, BMW, Honda, General Motors and Renault, began field testing in the US of 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 provide feedback on the decisions they make, their performance or percentage of accurate decisions increases until they perform their functions far better than their former human counterparts.

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 practiced 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 cost savings and reduction 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. In Q4 of 2019, HSBC applied blockchain technology to a letter of credit transaction for MTC Electronic exporting LCD parts to its parent company, Shenzhen MTC, based across the border in China. The transaction was completed in 24 hours, compared to the typical five to 10 days for conventional document exchange.[4]

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 Q2 of 2019, breakbulk shipping venture G2 Ocean and blockchain startup Cargo X completed a pilot that used blockchain technology to carry out paperless bills of lading. During the trial, the two companies transferred ownership of goods with shipments traveling from China to Peru. 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. The importer received the electronic bill of lading after only a couple of minutes of delivery. In all, five separate shipments were completed as part of the pilot.[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, Topco Associates, LLC, a leading US food cooperative, began using Mastercard's blockchain-based Provenance Solution to help its member supermarkets trace and highlight the origin of food.[6] 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 is 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 programs, 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. Through 2022, 80% of supply chain blockchain initiatives will remain at a proof-of-concept or pilot stage.[7] To be fair, the transition to Trade Finance 2.0 is not remotely finished and ninety-some percent of 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 programs 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.

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. One of the most well-known is Cosmos, which aims to act as an ecosystem of blockchains that can scale and interoperate with each other. 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 10 years. Be skeptical 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 programs and proof of concepts 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 mutualization 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 centralized 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 decentralized system must be operational; thus, resulting in each company paying 1/10,000th of the costs of such decentralized 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 mutualize the cost of compliance, and in doing so, improve the effectiveness of their overall programs. 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 license 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.

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Josias 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 center 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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2020: Financing Private Equity Transactions in a New Decade

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Introduction

2019 was another robust year in the private markets. Several principal trends have defined the private equity and leveraged finance market in 2019, and should continue into the new decade: private equity firms are armed and ready to deploy record amounts of more flexible capital; there are increasing alternative investment allocations to private debt funds under the management of multi-strategy asset managers; there is an expansion of the private debt market into large cap deals; and there is a divergence of financing terms based on borrower quality.

Raising, Deploying and Allocating Capital in the Private Markets

Private equity firms will continue to be a force in global leveraged finance deal volume in 2020 and beyond. Today, the private equity industry is one of the largest alternative asset classes in the world, with assets under management (AUM) reaching $4.11 trillion as of June 2019.[1] As investors continue to look for consistent returns, they are increasingly investing in private markets and private equity firms in particular, as a source of higher and sustained returns. Additionally, as hedge funds have lost favour over the past few years, one of the principal beneficiaries has been private equity firms. In 2019, hedge funds made up 33% of institutional investors' allocations to alternatives (a 7% drop from 2018), while private equity grew to 25% of investors' alternative investments (up from 18% in 2018).[2] This is particularly pertinent as more traditional asset classes offer historically low yields, notably the majority of bond markets (investment-grade corporate bonds yield just over 3%—well below most institutions' target rate of return).[3] Additional factors that should support the continued growth in allocations to private equity and private debt investments are recent market and regulatory initiatives that are designed to facilitate greater participation by retail investors.

As investors have continued to allocate assets to the private markets, private equity firms and other asset managers are looking to deploy record amounts of equity capital—some put this dry powder at as much as $1.7 trillion. According to a market study performed in the second quarter of 2019 by Mergermarket, on behalf of Dechert LLP, which surveyed 100 senior-level executives within private equity firms across the globe that were not first time funds and who had $500 million or more in assets under management (the "Merger Market Report"), 24% of the respondents said that "convincing investors their capital will be put to work quickly is proving to be difficult". The challenge facing these respondents is the result of the continued influx of capital in the private markets, strong competition and rising asset prices.

In order to continue to deploy capital, many private equity firms have been and will pay higher multiples with increased leverage (i.e., more debt). According to the Merger Market Report, the median price-to-EBITDA multiple for deals globally has risen steadily after formerly peaking in 2007, reaching a level of 11.5× by the start of 2019.

The private debt markets have responded to the demand for leverage to support higher acquisition earnings multiples. Assets under management in private debt climbed to $812 billion in 2019. While private debt experienced a slight decrease in fundraising in 2019 as compared to 2018 ($104 billion *vs.* $120 billion), this was the fourth consecutive year that investors committed more than $100 billion to the asset class. One of the drivers of the increased allocation of assets to private debt is the diversification of asset classes within asset managers. As private equity firms leveraged their expertise in fund-raising and capital deployment, many have transitioned from single class asset managers (i.e. private equity) to multi-class asset managers, with one of the most in-demand asset classes being private debt. According to the Merger Market Study, 27% of respondents identified private debt and direct lending as the firm's top priority for expansion.

For many asset managers, expanding their product portfolio to include private debt offers a number of strategic benefits in addition to increasing assets under management and the related income streams, including satisfying demand from their existing institutional investors, enabling them to offer more flexible capital structures to support the leverage buyout market, leveraging existing investor and investee relationships. Investments in private debt result in a more rapid deployment of capital, as debt investments often can be deployed in the primary or secondary markets with less infrastructure support than traditional control buy-outs. Given the current demand for private debt as an asset class, when combined with the need for committed capital to support private equity transactions amid rising valuation multiples, we expect asset managers to continue raising and allocating capital to private debt funds.

Market Terms Diverge

The inextricable link between the search for yield, the diversification of investments and the continued competition by private debt funds to provide financing has resulted in many financing transactions executed with favourable and attractive borrowing terms. With this backdrop, 2019 financing terms remained favourable to borrowers and private equity sponsors. Although we believe this will continue into 2020 and beyond, there has been some bifurcation of market terms.

While the continued search for yield should support continued demand across the private markets for debt financing into 2020 and beyond, there appears to be a caution toward debt rated 'B' and lower. Late-cycle anxiety in 2019 resulted in corporate credits – those rated 'B' or below (where most leveraged buyout issuers sit) – facing headwinds in financing terms and rates as compared to higher-rated companies. Trade issues, increased pressure on yield and concerns over the possibility that we are reaching the peak of the current economic cycle are likely to continue the shift to quality credits. After tripling during 2019, the difference between the spread of BB/BB- rated issuers and B/B- has reached its highest level in 10 years. The fourth quarter of 2019 started with a continuation of credit risk aversion and bifurcation. As in years past, many private equity-backed borrowers responded to any challenges in the market with adjustments to offerings, including revising covenants and pricing.[4]

Expansion of Private Debt as an Asset Class

Following the 2008 financial crisis, the status quo was upended. As bank credit tightened and traditional commercial lenders exited the market as a result of decreased capacity to lend due to impaired balance sheets and heightened regulatory capital requirements, private debt funds were there to step in and fill the void; evolving from single lender financing arrangements into a source of liquidity for syndication, to acting as anchor investors for club deals, to acting as primary lender and lead arranger and competing with traditional banks for mandates. Private debt started as an alternative to traditional bank lending. It was generally used for smaller deals or riskier credits that the banks passed on as not fitting their investment profile. When compared to traditional commercial banking transactions, private debt also tended to be smaller in size, have higher coupons and shorter maturities and frequently occupied the junior capital layers in the capital structure. Accordingly, it did not pose a competitive threat to the traditional commercial banking industry. Rather, private debt has traditionally filled a gap in the market for businesses in need of financing which could not access customary commercial financing sources or needed an additional layer of debt beyond what those traditional sources would fund.

2019 marked another year of change in the private debt markets, as private credit transactions replaced traditional syndicated bank lending and high yield bond offerings in the large cap market. 2019 saw various deals in the $1 billion range, historically executed in the syndicated bank lending markets, travel to the private debt market. Some examples of these large cap deals in 2019 include: an Owl Rock Capital Partners led a group of private debt investors providing a $945 million unitranche loan to Integrity Marketing; Apollo's reported commitment of a $1.792 billion senior secured loan to finance the acquisition of Gannet by New Media Investment Group; and Golub Capital's role as sole lead arranger and administrative agent on a $950 million financing for the acquisition of Amber Road by E2Open.[5] This trend does not look to be slowing down either. As of late 2019, Apollo Global Management indicated that it will be pursuing deals in the $2 billion dollar range and Blackstone Group Inc. was in the process of pitching multiple billion-dollar financings.[6] There may be a litany of reasons for this development, including the need to deploy ever increasing amounts of private debt capital and the view that larger cap deals entail less risk than smaller market transactions due to the broader and frequently more diverse revenue bases of the larger borrowers, as well as deeper-pocketed sponsors able to provide their personnel and financial capital support.

However, while private debt fund managers have been particularly active within private equity-related deals, banks haven't disappeared as lenders in this area of financing. Goldman Sachs Group, for example, ranked among the top 10 lenders for U.S. buyouts based on the number of deals in 2019, announced that it plans to raise $8 billion in only its second buyout fund since the 2008 financial crisis, bolstering its ability to secure deals worldwide.[7] Credit Suisse was recently able to win the lead arranger role for traditional syndications: the Shields Health's leveraged buyout; and CityMD's acquisition of Summit Medical. Similarly, UBS was able to persuade both CoolSys and Vida Capital to elect publicly syndicated deals over placement with private lenders.[8] In addition, changes on the horizon in the bank regulatory landscape may create additional increased competition in the debt markets. On January 30, 2020, five federal financial regulators jointly issued a proposed rule that would modify existing regulations implementing the Volcker Rule's general prohibition on banking entities investing in, sponsoring, or having certain relationships with hedge funds or private equity funds (collectively, "covered funds"). The proposal, which follows a 2019 final rule revising the Volcker Rule's proprietary trading provisions, is intended to simplify the covered fund provisions, and permit banking entities to engage in additional fund-related activities that do not present the risks that the Volcker Rule was intended to address. The Volcker Rule permits banking entities that organise or offer covered funds to hold certain ownership interests. The proposed rule would clarify the definition of "ownership interest" by including additional characteristics that are features of an ownership interest (e.g., the right to participate in the selection or removal of a general partner, board director, investment manager, etc.). The proposal would clarify that loan or debt interests with certain creditor rights are not ownership interests and expressly exempt senior loans and senior debt.

Conclusion

While global market conditions have provided the industry with certain obstacles over the past few years, due to the combination of investors seeking higher yields, the amount of dry powder ready for deployment and the expansion of the markets in which private debt is used, we anticipate the private equity and private debt markets to continue to thrive in the coming decade.

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An Overview of Debtor in Possession Financing

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Introduction

When companies with existing credit facilities are in financial distress, whether as a result of adverse market forces, covenant or other defaults under their debt facilities or unexpected business interruption, they may lose access to liquidity under their existing credit facilities or face the potential exercise of remedies by lenders under their existing credit facilities. In such circumstances, since a leveraged company's assets are typically pledged to secure its existing indebtedness, it is nearly impossible to attract new capital to continue operations or to refinance existing debt. A chapter 11 bankruptcy can provide such a distressed company with an opportunity to obtain financing in the form of debtor in possession financing ("DIP Financing").

DIP Financing provides a lifeline to companies that would otherwise run out of cash and have no ability to satisfy near-term obligations, including debt service, payroll, rent and other operating expenses. Lenders may be willing to provide DIP Financing to otherwise non-credit-worthy companies because they receive lender protections that are not available outside of a chapter 11 process, including the ability to prime existing liens, court approval of the financing terms to avoid future challenges by other creditors and strict controls on how the borrower spends the funds.

While the benefits to the debtor are obvious, creditors and lenders have strategic incentives to provide or consent to the DIP Financing. As a simple economic matter, DIP Financings typically have higher interest rates and fees than lenders can obtain outside of chapter 11 for similar loans, and are a relatively safe investment due to the protections afforded by the Bankruptcy Code and the Bankruptcy Court. As a result, DIP Financing is a relatively safe high yielding investment.

In addition, the debtor's existing pre-bankruptcy lenders frequently use the various mechanisms available to DIP lenders to help protect their existing investment in the debtor and, in some cases, make a play for ownership of the reorganised entity post-emergence through the DIP Financing. An understanding of the basics of DIP Financing and how the various and often conflicting interests of the debtor, its DIP lenders, and creditors are addressed within a chapter 11 case provides a crucial insight into one of the driving forces of the reorganisation process.

DIP Financing Under the Bankruptcy Code

DIP Financing, like other aspects of chapter 11 bankruptcy, is governed by chapter 11 of Title 11 of the United States Code (the "Bankruptcy Code").[1] Specifically, section 364 of the Bankruptcy Code authorises DIP Financing arrangements by allowing the "debtor" to obtain post-petition (i.e., post-bankruptcy filing) credit.[2] It also incentivises both new and existing lenders to make loans by offering them special protections.

If the debtor needs to incur unsecured debt outside the ordinary course of business during the pendency of the chapter 11 case, it must obtain approval of the Bankruptcy Court under section 364(b) of the Bankruptcy Code. To encourage lenders ("DIP Lenders") to extend unsecured financing to a debtor, the Bankruptcy Code provides DIP Lenders with an administrative expense priority under section 503(b) of the Bankruptcy Code. Being granted a priority as an administrative expense means that a DIP Lender's claim for repayment of the unsecured DIP Financing will have priority over all other pre-petition unsecured claims, which must be paid in full, in cash in order for the debtor to emerge from bankruptcy, unless otherwise agreed to by the lender.

Often, a simple administrative expense priority is insufficient to induce lenders to provide unsecured DIP Financing. If the debtor is unable to obtain unsecured financing, the Bankruptcy Court may authorise a debtor to obtain secured financing under section 364(c) of the Bankruptcy Code. Under section 364(c), the DIP Lender's DIP Financing will be given a superpriority over any and all other administrative expenses of the estate along with a security interest in any unencumbered assets, or a junior lien on already encumbered assets. Credit obtained under section 364(c) not only requires the approval of the Bankruptcy Court, but also requires the debtor to prove to the court that it could not obtain financing on an unsecured basis.

If the debtor is still unable to obtain sufficient funding secured only by previously unencumbered assets and a junior lien on already encumbered assets, the debtor can obtain secured financing under section 364(d) of the Bankruptcy Code. Under that section, a debtor can also offer a priming lien, which is a lien on collateral senior to existing, pre-petition liens on such collateral and requires the DIP Lender's claims to be paid prior to the payment of claims by the existing lenders secured by the same collateral, regardless of whether the source of payment is the sale of proceeds of the common collateral. Financings under section 364(d) are similar to financings authorised under 364(c) in the sense that this section is only available to the debtor if the debtor proves to the Bankruptcy Court that, without a priming lien, it could not otherwise obtain such financing. This ability to offer a priming lien on already encumbered assets is not available outside of chapter 11 and is one of the primary reasons that debtors can attract DIP Financing in chapter 11 when access to credit, even secured debt, was unavailable outside of bankruptcy.[3]

While the ability to prime liens is of great benefit to DIP Lenders, because of the impact such liens have on the interests of the existing secured lenders, the Bankruptcy Code provides significant protections to the existing lenders whose liens are being primed. If the debtor seeks to prime existing liens, the debtor must either obtain consent from the lenders being primed or it must ensure that the interest of such lenders in the collateral is adequately protected against diminution of value resulting from the priming. Adequate protection, as defined in section 361 of the Bankruptcy Code, may include:

1. a cash payment or periodic cash payment by the debtor to the creditor to the extent that the value of the creditor's collateral depreciates or otherwise decreases;
2. an additional or replacement lien to make up for any decrease in the value of the creditor's collateral; or
3. granting such other relief as will result in the realisation of the "indubitable equivalent" of the creditor's interest in the collateral.

Existing lenders will typically resist getting primed and will challenge the adequacy of the protections being offered. Insofar as a contested priming fight can be a very difficult, highly contentious, and destabilising proceeding for the business, debtors typically try to avoid a "priming fight" in the early stages of its case and will seek consent from the existing lenders or negotiate with them to provide the DIP Financing. As a result, the priming DIP Financing is generally provided by existing lenders who prime their own existing liens as well as the liens of the co-lenders who do not participate in the DIP Financing.

Additional DIP Lender Incentives

There are a number of other reasons why a lender would be attracted to providing DIP Financing. First, DIP Financing typically provides lenders with relatively higher rates of interest than they would otherwise receive outside of chapter 11. The highest interest rate for DIP financings in 2019 was 20% in the chapter 11 cases of Remnant Oil and Generation Next Franchise Food Brands. On a sector basis, the highest interest rates came from the technology sectors, averaging 11.3% overall, followed by the energy sector at 8.6%, and the consumer staples sector at 8.3%.[4]

In addition, DIP Financing is a way for the debtor's existing lenders to safeguard the value of their existing loans to the company. In many cases, were the debtor forced to liquidate precipitously after running out of funds, such lenders would almost certainly be faced with significantly lower recoveries on their loans. DIP Financing signals to vendors and customers that the debtor has sufficient capital to continue operations during the bankruptcy process or to conduct an orderly sale or liquidation process that can help maximise the existing lender's recovery.

Furthermore, existing secured lenders may provide the DIP Financing as a defensive measure, as they may not want outside lenders to obtain junior or priming liens on the collateral that is already securing their loans or senior liens on unencumbered assets. Given their existing investment in the company, existing lenders often want to control their own destiny by providing the financing and dictating the direction and timeline of the chapter 11 proceeding. They risk losing such control if a third party lender comes in and provides the DIP Financing.

Lenders are always able to exert some control over their borrower through negotiated covenants in loan documents outside of bankruptcy. However, since typical corporate lending is not set up to closely monitor the borrower and close supervision has in some cases resulted in lender liability claims, outside of bankruptcy, lenders are typically hesitant to micromanage a borrower's actions. DIP Lenders' third party monitoring expenses are paid by the debtor. Moreover, the terms of their loans and the controls placed up on the debtor are approved by the Bankruptcy Court, and thus DIP Lenders are insulated from lender liability and similar claims. DIP Lenders can exert significant control over the debtor by requiring, among other things, strict compliance with an agreed-upon weekly budget and financial and non-financial covenants, detailed and frequent reporting, appointment of a chief restructuring officer acceptable to the DIP Lenders, and compliance with milestones for a condensed chapter 11 timeline.

While these controls keep a tight rein on the debtor's expenditures and provide the lender with very early warnings if the company deteriorates further, the DIP Financing milestones also provide the DIP Lender with significant control over the timing and direction of the case. For example, the DIP Financing may require the debtor to obtain court approval of a chapter 11 plan on an expedited timeline. The DIP Financing may also require a sale of substantially all of the debtor's assets under section 363 of the Bankruptcy Code if the plan milestones are not met.[5]

Where the DIP Lenders do not believe that a reorganisation of the debtor will be feasible or where they believe such reorganisation would be too costly or time-consuming, the DIP lenders may require the debtor to engage in a sale process quickly at the outset of the case. For example, given the current market pressures in the retail space, it is not uncommon for DIP Lenders providing financing to retailers to require a sale to occur within the first 30 to 60 days of the bankruptcy case.

A Bankruptcy Code 363 sale may be required by the DIP Financing (either from the outset or due to the debtor failing to meet a milestone). In such event, the DIP Lender has the advantage of being able to credit bid its secured claim under section 363(k) of the Bankruptcy Code. With a credit bid, a DIP Lender can use the amount of its secured claim to pay all or a portion of the sale price in an auction for the assets being sold, which protects the DIP Lender's interest in its collateral and ensures that its secured claim will not be undervalued.

Finally, existing pre-petition lenders that provide the DIP Financing may also negotiate for other special protections such as roll-up and cross-collateralisation provisions to ensure that their pre-petition claims are given priority over the claims of other pre-petition creditors. Roll-up provisions typically require the debtor to draw on the DIP Loan to pay off either some or all of the lender's pre-petition claims. In other words, the lender's pre-petition debt is "rolled up" into post-petition debt, which improves the lender's prospect of receiving a recovery on its pre-petition investment by elevating its pre-petition claim to a post-petition secured claim with a superpriority administrative expense status.

Cross-collateralisation is another avenue the parties may take to achieve the same result. Those provisions grant a debtor a security interest in otherwise unencumbered assets of the company for both the DIP Lender's pre- and post-petition claims.

It is worth noting that neither roll-ups nor cross-collateralisation are expressly authorised under section 364 of the Bankruptcy Code. Further, the improvement of the status of a DIP Lender's pre-petition claim over that of similarly situated pre-petition claims also conflicts with the general bankruptcy equitable principle that members of the same class of pre-petition claims receive equal treatment. Nevertheless, if the debtor has no other source of financing and lenders will not otherwise extend credit to the debtor without such provisions, Bankruptcy Courts frequently approve these provisions.

Lenders in syndicated credit facilities often take advantage of these benefits, as well as the ability to prime liens, to advantage their position over the other lenders within their credit facility. It is not unusual for several of the largest lenders under the existing facility to propose a DIP Financing that rolls up the pre-petition debt of the participating lenders and primes all of the liens securing the credit facility held by the non-participating existing lenders. If this group of lenders comprise the "required lenders" under the credit agreement, they may be able to direct the agent to consent to the priming of the liens and thus through the roll-up. Upon the roll-up, both the new money as well as their existing loans will become senior to the other lenders with whom they were previously *pari passu*. Of course, the minority lenders often object to such financing and may be afforded the opportunity to participate in the financing to resolve their objections.

Negotiating DIP Financing

Negotiating the DIP Financing is often undertaken during a compressed period of time, while the company is under significant financial strain and on the verge of running out of money. Given that the debtor is *in extremis* and often has no other options, DIP Lenders have significant leverage. Nevertheless, the Bankruptcy Court approval process helps to balance the leverage as the Bankruptcy Court may ultimately not approve provisions that it views as too onerous.

When negotiating the DIP Financing, as an in initial matter, the parties must agree on the type of chapter 11 case such as whether the case will involve a quick liquidation, an organised sale process or a lengthier reorganisation proceeding. Based on that, the parties must negotiate and agree upon the amount of financing needed and the structure of the loan. Depending on the anticipated length of the chapter 11 case and the agreed use of proceeds, the DIP Financing may be comprised of a term loan and/or a revolving credit facility (including asset-backed facilities). The parties also must negotiate the economic terms, the collateral securing the DIP Financing, including the interests to be primed, affirmative and negative covenants and other special protections like roll-ups and cross-collateralisation.

Determining the amount of DIP Financing required for a chapter 11 process is more complicated than simply determining the amount of money needed to keep the business' operations running at the status quo and pay for the chapter 11 case. It also involves a strategic analysis of how new financing might impact the perception of the company among its vendors and suppliers. Often, by the time a company has filed for bankruptcy, all trade credit has dried up and the company is operating on a cash-on-delivery basis. A key assumption in any DIP Financing budget is whether and how quickly trade credit will return. Given the strict budget compliance requirements, wrong assumptions on issues such as trade credit can quickly lead to a default under the DIP Financing.

DIP Financings are evidenced by loan documents that can be based on the loan documents for the debtor's existing debt. Even though the Bankruptcy Court order is sufficient to constitute a perfected priority security interest on collateral, DIP Lenders will typically document their security interests in collateral and take actions otherwise required by law to perfect those security interests. While it is generally the case that DIP Financings are made pursuant to executed loan documents, the Bankruptcy Court has the ability to approve DIP Financing terms, including priming liens, based on a term sheet which it may do under exigent circumstances, and the debtor and DIP Lenders will subsequently negotiate and execute loan documents.

Court Approval of DIP Financing

In any situation requiring court approval for DIP Financing, the debtor will need to file a motion with the Bankruptcy Court for authorisation to obtain post-petition credit ("DIP Motion"). The DIP Motion will be accompanied by the proposed order to be granted by the court ("DIP Order"), the underlying loan documents, as well as affidavits by the debtor explaining the process by which the financing was obtained and the need for the financing. Frequently, due to the short time frame before the filing, the parties are still negotiating the loan agreement when the motion is filed, so they may only attach to the motion a commitment letter or drafts of the loan agreement.

Approval of the DIP Financing is often a two-step process. As the DIP Motion is often filed on the first day of the bankruptcy case without the opportunity for the creditors of the debtor to receive more than a day or two's notice, the Bankruptcy Code only permits the bankruptcy judge to grant interim approval of the amount of the DIP Financing necessary to avoid irreparable harm to the debtor. The Bankruptcy Court will then hold a hearing during the first few days of the case to consider approval of disbursal of a portion of the DIP Financing on an interim basis. Thereafter, notice of the financing will be provided to all of the debtor's creditors and the court will hold a hearing at least 14 days later to consider final approval of the DIP Financing.

Because of the bifurcated hearing process, it is fairly common for creditors and creditors' committees to raise objections to the financing at the final hearing. Often, these objections will focus on the milestones and other controls placed on the debtor by the lender, the roll up and/or cross collateralisation and other protections and benefits built into the DIP Financing. Whether the court will approve these provisions despite the creditors' objections will often depend on the court's perceptions as to whether the lenders would still make the financing available even if the court cuts back or eliminates such protections and benefits.

Conclusion

With the continued need of chapter 11 restructuring for large and complex businesses, the importance of understanding the role that DIP Financing plays in such restructurings remains crucial to debtors and lenders alike. Financially distressed companies should allow as much time as possible to investigate the terms of all available sources of financing, and the challenges that each potential lender presents to its restructuring efforts. Lenders, on the other hand, should evaluate and weigh the benefits available as the provider of the DIP Financing. To do this, they must understand the full array of available protections and strategic control they may be able to exert on the debtor's case to best position themselves and protect their pre- and post-petition investments.

Endnotes

1. During a chapter 11 case, the debtor generally continues operations and restructures its debt under the Bankruptcy Court's protection and oversight, or can otherwise conduct an orderly liquidation or sale process. This is different than a chapter 7 case where a trustee is appointed to conduct a liquidation process.
2. A company operating under chapter 11 is referred to as the "debtor". Because the debtor remains in possession of its assets and its board remains in place, it is referred to as the debtor in possession.
3. There are many factors that may affect a lender's decision not to extend credit to a financially distressed company that has not yet filed for bankruptcy protection, such as potential avoidance actions or the impact of the automatic bankruptcy stay of creditor remedies.
4. Reorg Research, *2019 Year in Review* (Jan. 13, 2020).
5. Section 363 of the Bankruptcy Code provides, among other things, for the sale of a debtor's assets free and clear of all liens, claims, encumbrances and interests of third parties.

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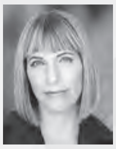
Acquisition Finance in Latin America: Navigating Diverse Legal Complexities in the Region[1]



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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. In 2019, despite a decline in global M&A activity, the M&A market in Latin America improved as compared to the year before, fuelled by inbound deals from around the world. In 2020, Latin American M&A should continue to attract international dealmakers whose willingness to invest in the region appears unaffected by recent political and socioeconomic turbulence.

For any acquisition finance transaction in Latin America, the parties will need to consider country-specific concerns, including guarantee 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.

M&A in Latin America

In Latin America, 2019 was marked by socioeconomic tensions in Chile, Colombia and Ecuador, tightening of external financing conditions in Argentina, and continuing anti-corruption investigations in Peru, among other headwinds. Despite these challenges, the 2019 Latin American M&A roster included 659 announced deals for a total of US$85.9 billion of value, which was an increase in value of 12.4% compared to 2018,[2] although by some accounts the level of Latin American M&A activity in 2019 was even higher.[3] This growth was attributable largely to inbound deals which amounted to almost 66% of the total Latin American M&A activity by value, with 40% of such inbound activity relating to the energy, mining and utilities sectors. The year also set a number of records for Latin American M&A activity. It was the most active year by value in Latin America for private equity buyouts, including a landmark US$4.5 billion acquisition of Red de Carreteras de Occidente in Mexico which was the second-largest leveraged buyout in Latin America since Mergermarket started keeping record in 2001. Likewise, real estate M&A in Latin America set a new record by value in 2019 and included the largest real estate deal in Latin America on record – the US$2.7 billion buyout of a stake in the Mexico-based Impulsora del Desarrollo y el Empleo en America Latina.[4] Brazil outperformed the rest of the countries in the region, finishing 2019 with a 26.3% increase in M&A activity compared to the year before, according to a Latinvex analysis of data from Refinitiv.[5]

For 2020, the International Monetary Fund is forecasting that the GDP in Latin America and the Caribbean will grow by 1.8%, with country-specific variations (Argentina: a decrease of 1.3%; Brazil: an increase of 2.0%; Chile: an increase of 3.0%; Colombia: an increase of 3.6%; Mexico: an increase of 1.3%; and Peru: an increase of 3.6%).[6] The Intralinks Deal Flow Predictor report predicts that through Q1 2020, Brazil, Chile, Colombia and Peru are expected to lead any increases in M&A announcements among the largest Latin American economies, whereas levels of M&A announcements are expected to be flat to declining in Argentina and Mexico.

Opportunities for International Lender Activity in Latin America

Despite the ongoing instability in the region, 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 launched a major infrastructure plan in 2018 through public-private partnership structures aimed to increase M&A activity in the country. This plan is expected to continue to provide opportunities for off-shore lenders to finance such M&A activity, albeit somewhat hindered by the devaluation of the Argentine peso and high inflation as well as Argentina's reinstatement of foreign exchange controls in cross-border financings. Following the election of Alberto Fernandez in the 2019 presidential elections, some multinational companies started to analyse divestments of local assets – a trend that is expected to continue in 2020. According to some sources, there may also be a wave of consolidation in banking, mass consumption and energy sectors as companies in financial distress are forced to sell, which may help fuel M&A activity in these industries.[7]
- In Brazil, although financing for acquisitions in the past has 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' retreat from activity should continue to 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. 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. With the progressive decrease of the public interest rate, the negotiation volumes at the Brazilian Stock Exchange (B3) have soared significantly in the past months,

and there is a trend suggesting that equity and debt transactions will intensify in 2020. Some of the more interesting transactions of 2019 in Brazil included: Petrobras's divestment of US$10.7 billion worth of assets to outside investors as part of the programme which is expected to continue in 2020 in accordance with Petrobras's 2019-2023 Business and Management Plan;[8] Softbank Group's investment in 10 deals across the region worth a combined US$2.3 billion, eight of which were in Brazil, with more on the horizon;[9] and the joint venture between Banco do Brasil and UBS, which is expected to create a new investment bank with operations in Latin America.[10]

- In Chile, the outlook for M&A activity in 2020 remains uncertain owing to the damage caused by violent protests and the slowdown in the economy. Nevertheless, the first 10 months of 2019 saw a year-on-year increase in deal-making, suggesting that there is potential for regaining investor confidence toward the end of 2020. The financial services sector as well as real estate and retail could see an uptick, according to some sources.[11]
- In Colombia, the government announced new regulations in 2019 that would allow it to offload stakes of up to 49% in state-owned companies (up 39% from the previous 10% limit).[12] This move is expected to pave the way for the sale of interests in the state-run oil company Ecopetrol and the regional electric power companies. While Colombia's economy is expected to grow by 3.6% in 2020,[13] the outlook for Colombian M&A activity in 2020 will depend, in part, on whether President Duque is able contain the social unrest contagion spreading from Chile and other countries in the region.
- In Mexico, the economic growth slowed sharply in 2019 owing to policy uncertainty and budget under-execution by President Lopez Obrador's administration. However, growth is expected to accelerate in 2020, on the back of strengthening consumption, large-scale public investment projects, and more coherent macroeconomic policies under the new administration.[14] In this context, M&A activity in Mexico may benefit from the US$42.95 billion infrastructure plan announced by the government in November 2019, which aims to boost investment in infrastructure with an active involvement of the private sector. The programme identifies 72 projects for 2020, worth US$22 billion, and is expected to be funded through a combination of local and international banks, pension funds (*SIEFORES*) and private investment funds. Furthermore, the administration's commitment to maintain fiscal prudence, headline inflation remaining within the central bank's target, and robust financial sector supervision may contribute to a stable investment environment in the near term.
- 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 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. There is, however, a new law that is expected to come into effect in Peru in 2020 pursuant to which the competition and intellectual property watchdog Indecopi will be granted the power to recommend changes or reject deals of certain sizes that are deemed potentially harmful to competition and consumers, which could increase the cost of some M&A transactions in Peru going forward.[15] Nevertheless, the projected acceleration of economic growth in Peru is expected to generate more opportunities for M&A activity in 2020 particularly in the manufacturing, private consumption, energy and logistics sectors.[16]

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$85.9 billion in 2019) are still a fraction of US M&A activity (US$1.57 trillion in 2019) and European M&A activity (US$770.5 billion in 2019).[17] 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[18] that applies in the purchase agreement – to eliminate any potential daylight between the loan commitment and the purchase obligation.[19]

Security Principles

Lenders in the UK, the European markets and the US markets also include in the commitment documentation an agreed description of the guarantee and security principles that will apply to complete the credit support package after closing. In the UK and the European markets, the guarantee and collateral package will vary considerably depending on the applicable jurisdictions involved, given wide variance in applicable guarantee limitations and security interest legal regimes in the region. In the US, the parties often agree to limit the collateral and guarantee 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 guarantee 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 guarantee 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" guarantee 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 guarantee provides arm's-length benefit to the Argentine guarantor and the required corporate formalities are complied with, the guarantee 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. Law No, 27,440 in Argentina recognised the concept of collateral agency, so lenders do not need to be a party to the local security documents and intercreditor arrangements relating to 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. Recent changes to Brazilian law have enhanced the attractiveness of the Brazilian legal regime to the international lenders. The Brazilian Declaration of Economic Freedom (Law No. 13,874/2019) introduced some improvements for the private sector which aim at confirming a free market economy as well as reducing the bureaucracy involved in entrepreneurial activities. It offers an interpretive guideline to the main civil rules to assess the parties' economic freedom and good faith. Also, it establishes rules and principles to protect free initiative, such as the guarantee of freedom in doing business. It should be noted that such law also contains a provision allowing single partner limited liability companies (*limitadas*), which was a long-standing demand from the market.

In Chile, so long as the guarantee provides some benefit to the Chilean guarantor and the required corporate formalities are complied with, the guarantee 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 guarantee the applicable obligations, the guarantee 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 guarantee 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 guarantee 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. Recently, a finance structure has been implemented in the local market that combines a programme for issuances of securitisation notes backed by a *Fideicomiso de Titulización*, with the feasibility for the originator of the trust to enter into structured financing facilities, that will be also guaranteed by the same *Fideicomiso de Titulización*, all of them under creditors' common rules contemplated in the *Acto Constitutivo del Fideicomiso de Titulización* and in a creditor's agreement, which cover payment ranking among creditors, decision-making and enforcement of the securitisation trust, among other issues concerning the relationship among creditors (bondholders and holders of the financing facilities). 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 the non-resident Lender: (a) is a bank or financial institution under the supervision of the relevant central bank or equivalent authority of its jurisdiction, and (b) is located in a jurisdiction that is not considered to be a "low tax jurisdiction" in accordance with Argentine regulations, 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, 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 withholding 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 bondholders, 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, 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 10% depending on the country. However, if a lender is located in a tax haven jurisdiction, the applicable rate is increased to 33% in 2019 and 32% in 2020.

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 were reinstated in September 2019. The Argentine Central Bank establishes the obligation to transfer and sell for Argentine Pesos in the foreign exchange market all funds disbursed on or after September 1, 2019, in order to access the foreign exchange market to purchase foreign currency to service principal and interest payments. Prior approval of the Argentine Central Bank will be required for prepayments made more than three business days prior to maturity, unless prepayment is made with the proceeds of a new indebtedness already transferred and sold for pesos in the foreign exchange market.

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. Also, it is worth mentioning that the Central Bank of Brazil has proposed to Congress a foreign exchange reform law which aims to modernise the Brazilian foreign exchange industry and could potentially further open Brazil to the global economy.

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, 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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17. Mergermarket, *Global and Regional M&A Report 2019* (2019).
18. 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.
19. 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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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 $770 billion in enterprise value in 2019, midstream continues to be a large component of the oil and gas sector in the United States.[1]

In terms of pipelines, the U.S. network is the largest in the world, extending about 3 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 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.

In addition, there is continued build out of natural gas, NGL and oil pipelines to demand centres in the South Gulf Coast, such as South Texas and Louisiana. Much of the pipeline capacity added in 2019 was built to provide such capacity. These pipeline projects include Kinder Morgan's Gulf Coast Express Pipeline (which is expected to transport hydrocarbons to the Gulf Coast), El Paso Natural Gas Pipeline's Northern Delaware Basin Expansion Project, Cheniere's MIDSHIP Pipeline (which will deliver natural gas from Oklahoma to the Sabine Pass LNG Facility) and Texas East Transmission Company's Stratton Ridge Expansion (which will deliver gas to the Freeport LNG facility).[7] The expansion of delivery pipelines to the Gulf Coast is expected to spur further development of new downstream facilities and storage terminal projects over the coming years, including methanol, ethylene, ammonia and LNG export facilities. As a result, new greenfield industrial facility developments would also require significant capital investments over the coming years.

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 first-hand 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 six 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 in the last couple of years, 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 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, when 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.[8]

The Field Today

As of the end of 2019, private equity continued to increase its significant foothold in various of the key midstream regions (a trend that began in earnest in 2017), 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.[9] 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.[10] 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 Utica shales to markets across the United States and Canada.[11]

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.[12] 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.[13] A parallel crude pipeline project is also being developed by Ares-backed EPIC.[14] 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.[15] In respect of other midstream asset sub-classes, ArcLight Capital Partners in late 2018 acquired from Targa Resources assets including a refined products and crude oil storage and terminal facilities in Tacoma, Washington and Baltimore, Maryland.[16]

2019 witnessed continued growth in private equity investments in the midstream sector, driven somewhat by the downward-trending equity prices of midstream companies. Leading examples are Blackstone Infrastructure Partners' acquisition of the general partner of Tallgrass Energy (TGE) and 44% interest in TGE for $3.3 billion.[17] Credit Suisse arranged a $1.155 billion senior secured facility to fund a portion of the transaction consideration.[18] Funds managed by Blackstone Tactical Opportunities and GSO Capital Partners purchased a 45% interest in Targa Badlands for $1.6 billion.[19] The Williams Companies (WMB) and the Canada Pension Plan Investment Board (CPPIB) announced a JV in the Marcellus and Utica shales, with CPPIB investing $1.34 billion for a 35% interest in WMB's now wholly owned Ohio Valley Midstream and Utica East Ohio Midstream systems.[20] Stonepeak Infrastructure Partners acquired Oryx Midstream, the largest privately held midstream crude operator in the Permian Basin, for $3.6 billion.[21] Following the acquisition, Oryx Midstream announced that an affiliate of Qatar Investment Authority acquired a significant stake in Oryx Midstream from Stonepeak Infrastructure Partners.[22] S&P reported that of the eight announced deals in excess of $1 billion for which transaction value was reported in the first half of 2019, only two involved MLPs (MPLX LP and EQM Midstream Partners LP).[23]

Investments in the midstream sector have not remained confined to domestic funds. The growing involvement of foreign private equity firms in financing midstream oil and gas companies is yet another emerging trend from 2019. In addition to the Qatar Investment Authority investment mentioned above, Kodiak Gas Services, the largest privately held US contract compression company, was acquired in early 2019 by Sweden-based EQT Infrastructure (for an undisclosed amount).[24] A fund managed by Canadian firm Brookfield Asset Management acquired a 25% non-controlling stake in Dominion Energy Cove Point LNG, an owner of a Maryland LNG import, export and storage facility, for $2.1 billion.[25] In late 2019, IFM Investors, an Australian investment management company with roughly $39.1 billion assets in infrastructure, acquired Buckeye Partners through one of its entities for $6.5 billion.[26] Buckeye Partners operates one of the largest diversified networks of integrated midstream assets across North America, including 6,000 miles of pipelines along with a network of marine terminals.

Finally, water asset transactions comprised a growing segment of the midstream activity; 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.[27] 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.[28] In June 2019, WaterBridge Holdings LLC announced the closing of a significant transaction that provided additional expansion capital and operational scale, including a $1 billion TLB, a $150 million revolving credit facility led by SunTrust Bank and Barclays with a syndicate of 13 financial institutions and the acquisition of the Delaware Basin-produced water infrastructure of PDC Energy Inc. Waterbridge's announcement followed a previously announced minority investment from GIC Private Limited.[29] Also, in June 2019, XPV Water Partners, a growth private equity investor focused on making investments in companies related to the treatment and management of the world's water resources, announced that it acquired a minority stake in Metron-Farnier, a manufacturer of high performance and smart residential and commercial water meters.

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".[30] 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 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".[31]

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 2019, 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".[32] 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, 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. In addition, private equity money and commercial lending has shifted away from any significant new investments in the upstream sector. This pulling back from oil & gas by financial institutions and investors is a trend that is expected to accelerate during the coming years, particularly in light of recent commitments by 130 international banks to support implementation of the Paris Climate Agreement by signing the "Principles for Responsible Banking", which was launched at the UN General Assembly in September 2019.[33] Thirty banks led the development of the Principles for Responsible Banking, including Barclays, BNP Paribas, Citigroup, ICBC, ING, Natixis, and Société Générale.

With the coming of investment by private equity into 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; however, 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.[34] 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.[35]

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. By 2022, it is expected that new pipelines to the U.S. Gulf Coast will carry an additional 2.5 million barrels per day (bpd) of crude.[36] 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. Increased activity in the downstream sector as a result of recent midstream buildout will likely require access to non-traditional pockets of capital, particularly given the focus of traditional project finance lenders on seeking sustainable energy investments, as laid out in the Principles for Responsible Banking. While downstream projects traditionally have been project financed, the evolution of midstream finance structures may change how downstream and other oil & gas assets are financed. In addition, one other 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 and in the United States and is now accelerating 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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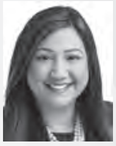
Countdown to 2021: The End of LIBOR and the Rise of SOFR


Kalyan ("Kal") Das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Introduction

In April of 2018, the market saw the Federal Reserve Bank of New York (the "New York Fed") take the first significant step toward the transition away from LIBOR by publishing three alternative reference rates based on overnight repurchase agreement transactions which are collateralised by U.S Treasury securities. These alternative reference rates were (i) 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, (ii) the Broad General Collateral Rate (the "BGCR"), which is a measure of rates on overnight Treasury general collateral repurchase transactions, and (iii) the Secured Overnight Financing Rate ("SOFR"), an index that reflects a broad measure of the cost of borrowing cash overnight collateralised by Treasury securities. SOFR was the leading alternative reference rate, and in September 2018 the U.S. Alternative Reference Rates Committee ("ARRC") published 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. These consultations addressed the question of what rate does a loan fall back to when LIBOR disappears, and concluded that a SOFR-based successor rate is appropriate. 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 achieved between now and 2021 to ensure a smooth transition.[1] In April of 2019, the ARRC released a User's Guide to SOFR and also published its recommended fallback language for floating rate notes and syndicated loans. These publications were big steps in the move toward SOFR as a replacement benchmark as the market prepared for LIBOR cessation.

2019 Developments – SOFR Replacement Benchmarks Take Shape

In addition to the ARRC's publication of a User's Guide to SOFR and recommended fallback language, the ARRC continued to work towards recommendations and consultations for various specified segments of the financial markets. Market organisations such as the International Swaps and Derivatives Association ("ISDA") and the Loan Syndications & Trading Association (the "LSTA") also proceeded with proposals and initiatives to help the swaps and derivatives market and the loan market, respectively, prepare for the end of LIBOR and implementation of a SOFR-based replacement benchmark. Regulators also weighed in, with the Securities and Exchange Commission (the "SEC") and the Office of the Comptroller of the Currency (the "OCC") issuing statements and guidance on the LIBOR transition.

ISDA

ISDA identified SOFR compounded setting in arrears as the preferred fallback rate in a report that it published in December of 2018.[2] Following a consultation published in July of 2018, ISDA published a second consultation on benchmark fallbacks in May of 2019,[3] which sought input on a proposed approach to address spread adjustments which would apply to replacement rates if fallbacks are triggered. In November of 2019, ISDA published a report summarising the results of the May 2019 consultation, which confirmed the preference for a SOFR compounded setting in arrears rate.[4] Based on the report, ISDA will amend the 2006 ISDA Definitions to incorporate fallbacks along with publishing a protocol for legacy contracts.

LSTA

The LSTA has been an active member of the ARRC, particularly as co-chair of the ARRC's Business Loans Working Group and the Business Loans Operating Subgroup and as a member of the Securitization Working Group. The LSTA has been actively involved in the development of fallback language through the ARRC. In addition to its role in the ARRC, the LSTA has and continues to publish many advisories, articles and guidance regarding LIBOR transition in addition to holding webinars and participating in panels and other events to educate market participants on the cessation of LIBOR and the impending transition to SOFR. Notably, in 2019, the LSTA published a draft "concept credit agreement" with a SOFR compounded in arrears rate.[5] The concept credit agreement is meant to aid the market in understanding and implementing SOFR-based alternatives, with SOFR compounded in arrears being just one option.

The Regulators Weigh In

In 2019, both the SEC and the OCC weighed in on LIBOR cessation and provided guidance to regulated entities and banks, respectively, regarding related risks. The SEC issued a "Staff Statement on LIBOR Transition" which specifically addressed risks and concerns for existing contracts and new contracts.[6] The SEC encouraged market participants to begin, if they have not already, to identify legacy LIBOR contracts extending past 2021 and evaluate their exposure and mitigate risks by evaluating whether or not such contracts contemplate and/or address the discontinuation of LIBOR. The SEC also recommended that market participants include fallback language in any new contracts that reference LIBOR or consider whether such contracts should reference LIBOR at all. The SEC's statement also provided division-specific guidance on addressing and responding to the risks associated with LIBOR cessation.

The OCC issued its "Semiannual Risk Perspective for Fall 2019", outlining potential operational and credit risk associated with LIBOR cessation for national banks and federal savings banks.[7] Significantly, the OCC is increasing regulatory oversight and recommends that banks should be focused on awareness and preparedness and assess their exposure and develop risk management strategies.

The Transition Begins – SOFR-based Deals?

In July of 2019, Fannie Mae issued floating-rate securities based on SOFR, a first for the market. The transaction was a $6 billion, three-part deal. In December of 2019, Royal Dutch Shell plc ("Shell") announced a $10 billion SOFR-linked revolving credit facility. It was the first syndicated loan tied to SOFR. Although the facility will be LIBOR-based initially, it is set to replace LIBOR with SOFR as early as the first anniversary of its signing. The Shell transaction has been lauded in the markets as a major step toward SOFR-based loans given that it is set to transition to SOFR before LIBOR ceases. The market can expect to see more SOFR-based contracts as we head into 2020 and inch closer to LIBOR cessation in 2021.

Replacement Benchmark Rates

Following market development and the ARRC recommendations, we now know that the likely replacement rate for LIBOR will be a SOFR-based rate. What exact formulation of SOFR, remains to be seen, but there are five possible candidates. The SOFR-based options essentially are (i) a daily SOFR, (ii) a forward-looking SOFR or a forward-looking term SOFR, (iii) a SOFR compounded in advance, (iv) a SOFR compounded in arrears or a compounded setting in arrears, and (v) a simple SOFR in arrears. Each of these variants of SOFR have their advantages and disadvantages, making some constructions more appealing than others.

Daily SOFR

Daily SOFR would simply be SOFR as published daily by the New York Fed. The New York Fed reports SOFR each business day at 8 a.m. Eastern Time. There is not much to it. It is a simple rate, easy to operationalise and identify and an unlikely candidate to replace LIBOR in most transactions because it is just a simple daily rate.

Forward-Looking SOFR/Forward-Looking Term SOFR

Forward-looking SOFR or forward-looking term SOFR does not yet exist, but would be a rate based on SOFR futures contracts, and likely quoted for one-month and three-month terms. While SOFR futures contracts are offered and a trading market does exist, a robust SOFR futures trading market would need to develop in order to establish a forward-looking term SOFR that would be an appropriate reference rate. Forward-looking term SOFR has the advantage of feeling more like LIBOR; it is a rate that would be known at the beginning of the relevant period and would be easy to operationalise. It does not, however, exist and may never exist and therefore is not a workable option – for now.

SOFR Compounded in Advance

SOFR compounded in advance is a SOFR-based rate compounded for the prior period, such that for a one-month period, it would reflect SOFR compounded for the prior month, and for a three-month period it would reflect SOFR compounded for the prior three-month period. It has the advantage of being a rate known at the start of a period, and the disadvantage of being seen as stale since it is based on the prior period. It would not be difficult to operationalise. SOFR compounded in advance, however, is not a likely replacement for LIBOR in most transactions, given that market participants typically prefer a more current and real-time rate to replace LIBOR.

SOFR Compounded in Arrears/SOFR Compounded Setting in Arrears

SOFR compounded in arrears, also known as compounded setting in arrears, is a rate compounded during the relevant interest period. For a one-month interest period, rather than looking back and compounding SOFR for the prior one-month period, as would be done for SOFR compounded in advance, SOFR compounded in arrears would compound over the actual period. This rate would utilise a look-back period in order to calculate it before the end of the period and as a result would require material documentation changes, significant notice alterations and be difficult to operationalise. These complexities present significant disadvantages which are further complicated by the fact that the rate is not known at the start of the period. It is very different from LIBOR, however; unlike SOFR compounded in advance, it would not appear stale. Despite its challenges, it is the preferred rate among many segments of the market, as it does not suffer from many of the disadvantages the other LIBOR replacement candidates suffer from. ISDA has already selected it as the replacement rate for LIBOR in its contracts and the loan market is also currently leaning heavily towards it.

Daily Simple SOFR in Arrears

Daily simple SOFR in arrears is simply just that, SOFR averaged for the interest period. It is similar to SOFR compounded in arrears because it is calculated during the interest period and is therefore not known at the start of the period, which as discussed, is challenging. It is, however, a simple average, and therefore easier to operationalise than SOFR compounded in arrears.

Challenges Ahead

Legacy Deals

As 2021 rapidly approaches, the big elephant in the room continues to be legacy transactions. Transactions pegged to LIBOR and consummated long before anyone contemplated that LIBOR may cease to exist, typically provide little or no guidance for replacing LIBOR other than obtaining unanimous investor consent. Accomplishing an appropriate transition for these transactions will need to be carefully thought out. An amendment approach could be the answer; however, such an approach likely requires unanimous investor consent, which would prove administratively and practically challenging, especially in structured finance transactions. Market participants in these legacy transactions need to begin considering their options and preparing to amend their transaction documentation to include fallback or replacement benchmarks in advance of the 2021 transition.

For short- and shorter-term financial products that are LIBOR-based, this may not be as much of an issue since many of these products will mature before LIBOR ceases. The challenge is far greater for longer term financial products, and in particular, structured finance transactions with maturity dates that exceed 2021 and which may be further complicated by the use of globally held notes through a depositary. In those transactions, it is not typical, even for the most non-controversial and mundane amendments, to expect to receive 100% noteholder consent, which is typically the threshold of investor consent required in order to amend interest rate provisions. For amendments aimed at replacing the interest benchmark and convention, there will likely be differing views among the investor community regarding what benchmark and construction is appropriate under the circumstances, particularly in transactions composed of different tranches of notes with different economic rights, and thus unanimous investor consent in such circumstances will be untenable.

There may be judicial or other mechanisms that transaction parties can explore in order to amend their transaction documents and implement a replacement benchmark without obtaining the unanimous consent of the investors. Many market participants are also speculating that legislative intervention may be possible, but given that not all transactions are governed by the same law, it would require legislative intervention across all jurisdictions.

How legacy transactions will be addressed remains to be seen, but as 2021 quickly approaches market participants must remain vigilant and informed and be prepared to act in advance of a benchmark discontinuation event, as the consequence of inaction may result in an unintended zombie rate.

The Amendment Approach vs. The Hardwired Approach

In recent and new transactions, parties can expect to see the cessation of LIBOR and replacement fallback provisions addressed in one of two ways: an amendment approach or a hardwired approach. The amendment approach essentially provides an amendment process by which parties can amend the transaction documents to implement a replacement benchmark at such time that a benchmark discontinuation event occurs. It provides optionality and flexibility, allowing deal parties to select replacement rates and spreads in the future when more information is available. The amendment approach was, and remains, the preferred approach among most market participants after it was announced that LIBOR would cease to be reported in 2021. The downside to the amendment approach is that it provides no certainty as to what the replacement benchmark will be when LIBOR ceases, which can be challenging for borrowers, issuers and investors alike. Now that there is more certainty in the market as to a SOFR-based replacement benchmark, a hardwired approach may be the more appropriate solution for LIBOR-based transactions executed between now and the end of 2021. A hardwired approach provides parties with either a determined fallback rate or a waterfall of fallbacks. It provides economic and operational certainty, neither of which can be underestimated. The more certainty the market has about replacement rates, the less disruptive the end of LIBOR will be.

Operational Challenges

Implementing a new SOFR-based benchmark presents many operational challenges for the market. SOFR, a secured, risk-free rate, is different than LIBOR, and as discussed above, many of the SOFR-based benchmarks operate much differently than LIBOR. Operational challenges are greater for those rates not known in advance, such as SOFR compounded in arrears. Since the rate will not be known until the end of the period, a borrower on a loan facility could not be invoiced until the day the payment is due, which is not practical. These rates will likely include some type of look back period, for example three days or five days, permitting the borrower to be invoiced in advance of the payment date. The spread adjustments that SOFR-based rates will require add another layer of complexity for calculating and operationalising these rates. Systems will need to be updated to operationalise SOFR, which will take some time. In November, the New York Fed announced its plan to publish three daily compounded averages for SOFR – 30-, 90- and 180-day averages – in the first half of 2020 and requested public comment on the proposal.[8] These published averages, along with a daily SOFR index, which the New York Fed also plans to publish, would ease the operational burden of calculating compounded SOFR-based rates. Market participants will need to be educated to understand the operational aspects of SOFR and SOFR-based rates since they will function much differently than LIBOR.

A Look Ahead

What can we expect for 2020? It is certainly the year when the market will need to take active steps to prepare for the transition away from LIBOR with less than two years left before LIBOR reporting ceases at the end of 2021. The ARRC and organisations like the LSTA, ISDA and others will continue to publish recommended fallback language and model provisions for SOFR-based contracts while also educating the market about the transition, next steps, risks and what to expect. Banks and other market participants, if they have not already, should establish protocols for implementing and operationalising replacement benchmark rates. Market participants should review their existing contracts for exposure to LIBOR and take steps to mitigate risks by evaluating such exposure, the steps required to implement a replacement rate, and the impact on portfolios, reporting, trading and valuation. Great progress was made in 2019, but much work remains to be done. Vendors should update their systems and software to operationalise SOFR. Although often overlooked or under-appreciated, the importance of these updates cannot be understated. We can expect a SOFR Index and published compounded averages in the first half of 2020, which may encourage a transition to SOFR prior to a benchmark discontinuation event. SOFR-based rates are now a more certain reality and the models and fallback language now exist, but market participants must work collaboratively to actively adopt the appropriate processes and solutions to fit the particulars of their transactions and ultimately face the challenge of preparing legacy transactions for a marketplace after LIBOR.

Endnotes

1. "Timeline for the Paced Transition Plan adopted by the ARRC on October 31, 2017", available at https://www.newyorkfed.org/medialibrary/microsites/arrc/files/2017/October-31-2017-ARRC-minutes.pdf.
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3. "Supplemental Consultation on Spread and Term Adjustments for Fallbacks in Derivatives Referencing USD LIBOR, CDOR and HIBOR and Certain Aspects of Fallbacks for Derivatives Referencing SOR", available at https://www.isda.org/2019/05/16/may-2019-benchmark-fallbacks-consultations/.
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6. "Staff Statement on LIBOR Transition" can be found at https://www.sec.gov/news/public-statement/libor-transition.
7. "OCC Semiannual Risk Perspective for Fall 2019" can be found at https://occ.gov/news-issuances/news-releases/2019/nr-occ-2019-145.html.
8. https://www.newyorkfed.org/markets/opolicy/operating_policy_191104.

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Sustainability finance has reached a tipping point in the global financial markets. According to the Climate Bonds Initiative, in 2019 global "green bond" issuance was $248 billion, up from $170 billion in 2018. Global "green loan" issuance comprised another $10 billion in 2019. Most significantly, sustainability-linked loans (SLLs) saw the biggest growth in 2019 with more than $122 billion of issuance, up from $72 billion in 2018, as reported by BloombergNEF.

The energy and natural resources sector is in a period of change where social license to operate and capital flow are transitioning to a lower emissions and socio-economically prioritized economy; as a result the oil & gas and mining & metals sectors are increasingly suffering from negative publicity around their perceived status as "dirty" industries, and digitalization and technology are significantly disrupting the way these industries operate. Additionally, an increasing number of governments are developing hydrogen-focused national policies and initiatives, and the International Energy Agency is preparing a major new study to assess the state of play for hydrogen, its economics and potential. The current hydrogen market is already big and growing, with a total demand of around 115 million metric tons in 2018, representing $135.5 billion. The hydrogen market also holds long-term promise, and is estimated to grow exponentially in the next few decades. Future applications include road transport, maritime and air transport, buildings and energy-intensive industries.

In February 2019, Rep. Alexandria Ocasio-Cortez (D-NY) and Sen. Ed Markey (D-Mass.) introduced in Congress a 14-page nonbinding resolution calling for the federal government to create a Green New Deal. The resolution has over 100 co-sponsors in Congress, including several Democratic presidential candidates. While not nearly as definitive as the European Green Deal, this is the most detailed plan yet to transform the US economy, even though the resolution is more a set of principles and goals rather than policies. The main goal of the plan is to bring US greenhouse gas emissions down to net-zero and meet 100% of power demand in the country through clean, renewable, and zero-emission energy sources by 2030.

In December 2019, the European Commission released a new climate change action plan that has been nicknamed the "European Green Deal." The plan's goal is to make the European Union's 28 countries "climate neutral" (i.e., eliminating 100% of the EU's net greenhouse gas emissions) by 2050. The European Green Deal proposes sweeping policy changes and a transformation of the European economy.

More recently, in January 2020, Larry Fink, Chairman and CEO of BlackRock, the world's largest asset manager with over $7 trillion of assets under management, issued a public letter to CEOs stating that "[c]limate change has become a defining factor in companies' long-term prospects" and he believes "we are on the edge of a fundamental reshaping of finance." Separately, BlackRock published its 2020 client letter in which it stated that "we believe that sustainability should be our new standard for investing."

Across the global financial markets, issuers and borrowers are seeing increased pressure from various stakeholders (regulators, investors, customers, employees) to incorporate sustainability into their business strategy and day-to-day operations. In addition, borrowers are starting to see real tangible value in developing more sustainability-focused business models. Green finance has created a new opportunity for issuers and borrowers to address the sustainability initiatives being demanded by stakeholders.

Moreover, independent oil and gas companies have committed to become net zero-carbon companies by 2050. In December 2019, Spain's Repsol, S.A. announced its zero-carbon plans and said it would take a €4.8 billion ($5.2 billion) write-down on its oil and gas assets as a result. On February 12, 2020, BP PLC announced that it is aiming to become a net zero-carbon company by 2050, a move that notably includes canceling out the greenhouse gas emissions contained in the oil and gas it extracts. Other companies have simply exited the oil and gas business altogether. Denmark's Orsted AS, which got its start drilling for oil and gas in the North Sea, gradually moved into the power sector and unloaded the last pieces of its oil and gas business in 2017. The company now defines itself as the world's largest offshore wind developer.

Like issuers and borrowers, lenders are also feeling pressure from their various stakeholders to promote and invest in companies with sustainability-focused business objectives. So far, the majority of SLLs have been made by lenders with a substantial relationship with the borrower. In addition, many global lenders have targeted allocations for loans to be made to Green companies or Green Projects. To increase the transparency and availability of information relating to a borrower's environmental, social and governance (ESG)-related positive and negative impacts, in February 2020, the Loan Syndications and Trading Association (LSTA) published an ESG borrower due diligence questionnaire that will provide lenders and investors with ESG-related information that can be incorporated into their investment decisions.

While there are no definitive statutes or regulations that define or describe what constitutes a Green Loan or an SLL, in the past several years a number of industry groups have developed and published guidelines for the emerging green finance industry with the International Capital Markets Association (ICMA), the Loan Market Association (LMA) in EMEA, the Asia Pacific Loan Market Association (APLMA) and the LSTA in the US taking leading roles in the development of such guidelines. These guidelines are intended to create more transparency and uniformity of "green" loan products as well as prevent borrowers from attempting to "greenwash" their loan by conveying a false impression or providing misleading information about the use of their green loan or SLL proceeds when, in fact, such proceeds are used in whole or in part for non-green purposes.

This article will highlight some of the factors driving the green finance industry and outline the guidelines for Green Loans and SLLs that are intended to foster growth of sustainability-focused financing.

Green Financing

The characterization of a financing product (whether loan or bond) as a "green" debt product can provide certain benefits to an issuer or borrower, such as attracting green-focused investors as well as the public relations benefits of investing in projects meeting certain "green" or ESG criteria.

As investors and companies embrace ESG objectives, green financing products have gained momentum as a source of funding and are now one of the debt markets' fastest growing segments. Many "green" renewable energy companies, sovereigns, supranationals and "brown" corporate issuers and borrowers are seeking to transition some or all of their business to "green" operations as their stakeholders are holding them more accountable for their environmental footprint.

The primary objective of the green debt market is to support the growth of environmentally sustainable economic activities that contribute to environmental objectives such as: climate change mitigation, climate change adaptation, natural resource conservation, biodiversity conservation, and pollution prevention and control.

Along with such potential benefits, issuers and borrowers undertake certain responsibilities and additional costs, including increased disclosure and third-party review both at issuance and periodically during the life of the loan. In addition, investor-specific criteria and different rules and regulations across jurisdictions can require an issuer to comply with additional local requirements that go beyond the requirements of the industry guidelines described below.

The Green Loan Principles

The Green Loan Principles (GLP) were jointly published in 2018 by the LMA, APLMA and LSTA with the support of ICMA and developed with substantial input from the constituent members of each organization. The GLP (and the SLLP described below) borrow heavily from the Green Bond Principles (GBP) established by ICMA in 2014. Like the GBP, the GLP were created to promote the development and integrity of the Green Loan product. The GLP build on and refer to the GBP, with a view to promoting consistency across financial products and markets.

The GLP have been designed to create a high-level framework of market guidelines to provide a consistent methodology for use across the Green Loan market. The GLP allow the loan product to retain its flexibility while preserving the integrity of the Green Loan market as it develops. The GLP are voluntary guidelines, to be applied by market participants on a deal-by-deal basis depending on the underlying characteristics of the transaction, that establish general parameters for a loan to be categorised as "green." Like the GBP, the GLP will be reviewed on a regular basis and updated where appropriate as the Green Loan market develops and expands.

Similar to Green Bonds, Green Loans include any type of loan instrument made available exclusively to finance or re-finance, in whole or in part, new and/or existing eligible "green projects." Green Loans must align with four core components of the GLP, which are described below. Identical to the categories outlined in the GBP, eligible "Green Project" categories include: (i) renewable energy; (ii) energy efficiency; (iii) pollution prevention and control; (iv) environmentally sustainable management of living natural resources and land use; (v) terrestrial and aquatic biodiversity conservation; (vi) clean transportation; (vii) sustainable water and wastewater management; (viii) climate change adaptation; (ix) eco-efficient and/or circular economy adapted products, production technologies and processes; and (x) green buildings that meet regional, nationally or internationally recognized standards or certifications. However, the GLP also recognize that definitions of "green" and "green projects" may vary depending on sector and geography.

Green Loan Principles – Core Components

The GLP establish a clear framework so that all market participants are able to clearly understand the characteristics of a Green Loan, based around the following four core components: (i) Use of Proceeds; (ii) Process for Project Evaluation and Selection; (iii) Management of Proceeds; and (iv) Reporting.

Use of Proceeds

The fundamental determinant of a Green Loan is whether the loan proceeds are used for Green Projects. The specific Green Projects to be funded with loan proceeds should be adequately described in the finance documents and, if applicable, any marketing materials. Each Green Project will be assessed, and where feasible, quantified, measured and reported by the borrower. Where funds are to be used, in whole or part, in connection with a refinancing, the GLP recommend that borrowers estimate the allocation of the loan proceeds between the financing versus refinancing.

A Green Loan may take the form of one or more tranches of a loan facility. In such cases, the green tranche(s) must be clearly designated, with proceeds of the green tranche(s) tracked by the borrower in an acceptable manner (whether through a separate account, borrower accounting notations or other manner that can be objectively recorded and tracked).

Process for Project Evaluation and Selection

The borrower of a Green Loan should clearly communicate to its lenders: (i) the borrower's environmental sustainability objectives; (ii) the process by which the borrower determines how its projects fit within the eligible categories; and (iii) the related eligibility criteria, including any exclusion criteria or any other process applied to identify and manage potentially material environmental risks associated with the Green Project(s). Borrowers are also encouraged to disclose any "green" standards or certifications to which they are seeking to conform.

Management of Proceeds

The proceeds of a Green Loan should be credited to a dedicated account or otherwise tracked by the borrower in an acceptable manner in order to maintain transparency. Where a Green Loan takes the form of one or more tranches of a loan facility, each "green" tranche must be clearly designated, with proceeds of the green tranche(s) credited to a separate account or sufficiently tracked by the borrower. Borrowers are encouraged to establish an internal governance process through which they can track the allocation of funds towards Green Projects. While the Green Loan is outstanding, the balance of the tracked net proceeds should be periodically adjusted to match allocations to eligible Green Projects made during that period. The GLP recommend that the management of proceeds be supplemented by the use of an auditor, or other third party, to verify the internal tracking method and the allocation of funds from the proceeds of the Green Loan.

Reporting

Borrowers should make and keep readily available up-to-date information on the use of proceeds and reported annually until fully drawn and as necessary thereafter in the event of any material developments. The report should include a list of the Green Projects to which the Green Loan proceeds have been allocated and a brief description of the projects and the amounts allocated and their expected impact. If confidentiality is a concern, or there are competitive considerations, or a large number of underlying projects limit the amount of detail that can be made available, the GLP recommend that information be presented in generic terms or on an aggregated project portfolio basis. The GLP recommend the use of qualitative performance indicators and, where possible, quantitative performance measures (for example, energy capacity, electricity generation, greenhouse gas emissions reduced/avoided, etc.) and disclosure of the key underlying methodology and/or assumptions used in the quantitative determination. Borrowers with the ability to monitor achieved impacts are encouraged to include those in regular reports. The use of a summary re ecting the main characteristics of the Green Loan and illustrating its key features in alignment with the four core components of the GLP may help inform market participants.

Review

In addition to the four core components, the GLP recommend that borrowers seek an external review when appropriate. There are a variety of ways for borrowers to obtain outside input into the formulation of their Green Loan process and there are several levels and types of review that can be provided to those institutions participating in the loan. Such guidance and external reviews might include: (i) consultant review or a second party opinion; (ii) independent verification by an auditor or independent ESG rating provider; (iii) certification in compliance with an external green assessment standard; or (iv) rating by qualified third parties, such as specialized research providers or rating agencies. An external review may be partial, covering only certain aspects of a borrower's Green Loan, or full, assessing alignment with all four core components of the GLP. It should be made available to all institutions participating in the Green Loan upon request.

Alternatively, because the loan market is traditionally a relationship-driven market, self-certification by a borrower that has demonstrated or developed the internal expertise to confirm alignment of the Green Loan with the key features of the GLP may be sufficient. In any case, borrowers are encouraged to thoroughly document such expertise, including the related internal processes and expertise of their staff and communicate this information to institutions participating in the loan upon request.

Application to Revolving Credit Facilities

The GLP have been drafted to apply to a wide variety of loan instruments, including term loans and revolving credit facilities. Although the use of proceeds of a term loan is usually identifiable, proceeds of revolving credit facilities may not identify in similar detail the use of proceeds for Green Projects. The parties to any proposed Green Loan taking the form of a revolving credit facility will need to determine how best to evidence the flow of funds to an agreed upon sustainability objective when applying the GLP to such a loan. A revolver may include a specific green tranche or a borrower may report to the lenders the use of any revolver borrowing and/or identify green assets supported by the revolving credit facility. Lenders may seek to monitor and validate the sustainability information provided by the borrower during the life of the loan, mindful of the need to preserve the integrity of the Green Loan product. In the absence of sufficient internal expertise at the lender to monitor the loan, external review is strongly recommended. Revolving credit facilities for general corporate purposes should not be categorized as "green" without satisfying the components listed in the GLP.

Sustainability-Linked Loans (SLLs)

One of the more recent developments in the global green finance market is the development of SLLs, which began with the Royal Phillips credit facility in April 2017.

The key difference between a Green Loan and an SLL is that the proceeds of a Green Loan must be used to finance a Green Project while the proceeds of an SLL can be used for any corporate purpose. For an SLL, the use of proceeds is irrelevant. Instead, the key factor for an SLL is whether the borrower has achieved the sustainability performance target(s) (SPT) that have been identified in the credit agreement.

An SLL is similar to most other loans in almost all respects except as to the pricing of the loan. The intent of an SLL is to create an economic incentive (through lower pricing if the loan meets a specifically defined SPT) and/or an economic penalty (through higher pricing if the loan fails to meet an SPT). For example, Belgian chemical company Solvay's €2bn SLL includes an ambitious greenhouse gas reduction target of one million tonnes of CO_2 by 2025; Thames Water, a UK utility company, completed a £1.4bn SLL that includes a link to the GRESB Infrastructure Score, an ESG benchmark for infrastructure assets; and Xylem Inc. tied its SLL pricing to social and corporate governance ratings by independent provider Sustainalytics.

The Sustainability-Linked Loan Principles (SLLP)

Published by the LMA, the APLMA and the LSTA in March 2019, the SLLP are the latest set of guidelines to be developed for the global green finance market. These guidelines address the growing green finance product offerings that are being developed in the market.

Similar to Green Bonds and Green Loans, SLLs are structured to facilitate and support environmentally and socially sustainable economic activity and growth. Like the GLP, the SLLP are voluntary guidelines intended to promote the development and preserve the integrity of the SLL product. The SLL product enables lenders to incentivize the sustainability performance of a borrower. The SLLP are intended for broad use by the market, providing a framework within which the flexibility of the loan product can be maintained, and will be reviewed on a regular basis to reflect changes in the market.

SLLs are any type of loan instrument and/or contingent facility (such as bonding lines, guarantee lines or letters of credit) that incentivize the borrower's achievement of ambitious, predetermined sustainability performance objectives. The borrower's sustainability performance is measured using SPTs, which include key performance indicators, external ratings and/or equivalent metrics and which measure improvements in the borrower's sustainability profile. SLLs look to improve the borrower's sustainability profile by aligning loan terms to the borrower's performance against the relevant predetermined SPTs. In some instances, a loan may be structured to allow for its categorization as both a Green Loan, aligned with the Green Loan Principles, and an SLL.

Sustainability Linked Loan Principles – Core Components

The SLLP set out a framework, enabling all market participants to clearly understand the characteristics of an SLL, based around the following four core components: (i) Relationship to Borrower's Overall Corporate Social Responsibility (CSR) Strategy; (ii) Target Setting – Measuring the Sustainability of the Borrower; (iii) Reporting; and (iv) Review.

Relationship to Borrower's Overall CSR Strategy

The borrower of an SLL should clearly communicate to its lenders its sustainability objectives, as set out in its CSR strategy, and how these align with its proposed SPTs. Borrowers are encouraged to position this information within the context of their overarching objectives, strategy, policy and/or processes relating to sustainability. Borrowers are also encouraged to disclose any sustainability standards or certifications to which they are seeking to conform.

Target Setting – Measuring the Sustainability of the Borrower

Appropriate SPTs should be negotiated and set between the borrower and lender group for each transaction. A borrower may elect to arrange its SLL with the assistance of one or more "Sustainability Coordinator(s)" or "Sustainability Structuring Agent(s)" and, where appointed, they will assist with negotiating the SPTs with the borrower. The SPTs should be ambitious and meaningful to the borrower's business and should be tied to a sustainability improvement in relation to a predetermined performance target benchmark. Market participants recognize that any targets should be based on recent performance levels (often data from the previous six to 12 months, but this will vary). SPTs may be either internal (defined by the borrower in line with their global sustainability strategy) or external (assessed by independent providers against external rating criteria). By linking the loan terms to the borrower's sustainability performance, borrowers are incentivized to make improvements to their sustainability profile over the term of the loan. Borrowers may be encouraged to seek a third-party opinion as to the appropriateness of their SPTs as a condition precedent to the relevant SLL product being made available. In cases where no third-party opinion is sought, the SLLP recommend that the borrower demonstrates or develops the internal expertise to verify its methodologies. The SPTs should be meaningful and apply over the life of the loan – one of the aims of SLLs is to encourage ambitious, positive change through incentives and this should form the basis of target setting.

Reporting

Borrowers should, where possible, make and keep readily available up to date information relating to their SPTs (such as any external ESG ratings), with such information to be provided to those institutions participating in the loan at least once per year. Since transparency is of particular value in this market, borrowers should be encouraged to publicly report information relating to their SPTs and this information will often be included in a borrower's annual report or its CSR report. However, this will not always be the case and, where appropriate, a borrower may choose to share this information privately with the lenders rather than making this publicly available. Borrowers are also encouraged to provide details of any underlying methodology and/or assumptions.

Review

External review should be considered for any SLL. For loans where information relating to SPTs is not made publicly available or otherwise accompanied by an audit/assurance statement, the SLLP recommend that a borrower should seek external review of its performance against its SPTs. For publicly traded companies, it may be sufficient for lenders to rely on the borrower's public disclosures to verify its performance against its SPTs. With respect to certain SPTs, even if data is publicly disclosed, verification of the borrower's sustainability performance by independent external review may still be desirable. In transactions where a borrower seeks independent verification, the borrower should have its performance against its SPTs independently verified by a qualified external reviewer (selected by the borrower and the lenders), such as an auditor, environmental consultant and/or independent ratings agency, at least once a year. In cases where no external review is sought, it is strongly recommended that the borrower demonstrates or develops the internal expertise to validate the calculation of its performance against its SPTs. Borrowers are recommended to thoroughly document any such expertise, including the related internal processes and expertise of their staff and communicated to all lenders participating in the loan. Once reporting has been completed and external review (if any) has taken place, the lenders will evaluate the borrower's performance against the SPTs based on the information provided.

As the financial markets continue to reflect the climate-focused interests of various stakeholders (including borrowers, lenders, investors, governments and the general public), we will continue to see growth and development of guidelines and market practices intended to generate additional investment in green and sustainability projects.

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2020 Private Credit Overview and Update: Financing the Middle Market


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Expanding financing sources and increased liquidity have powered robust growth in middle market lending over the last decade. On the private credit side, assets under management (AUM) have more than tripled in the last 10 years and exceed $800 billion as of the end of 2019.

There are some signs of this growth slowing, though. According to *Private Debt Investor*, private credit managers raised $147 billion in 2019, compared with $160 billion in 2018 and the high-water mark of $240 billion in 2017. However, the amounts raised in 2019 are not dissimilar from those raised in 2014, 2015, and 2016, so it appears that 2017 is the outlier and 2019 is a return to normal. That said, less than $30 million was raised in the last quarter of 2019 and lenders with a focus on distressed debt accounted for more than a third of all funds raised last year, indicating that investor appetites may be cooling and shifting. It is likely that investors' concerns over a possible economic slowdown are responsible. Nevertheless, with "dry powder" (funds available for investment) sitting at around a third of overall AUM, there is still plenty of liquidity to fuel deals in 2020 and beyond, if the markets remain stable. Even without a crystal ball, by reviewing the middle market and private credit landscapes, we can identify some key trends that we think will continue this year.

Middle Market Landscape

The global middle market is huge. In the U.S. alone, for example, more than 200,000 companies operate in the middle market, generating about a third of domestic production, employing close to 50 million people, and contributing more than $7 trillion to the economy each year.

Companies with revenues between $100 million and $500 million and earnings, before interest, taxes, depreciation, and amortization (EBITDA), of between $10 million and $50 million make up the core of the middle market. The category is also sometimes defined by financing, with loans ranging from $100 million to $500 million forming the bulk of the upper middle market and those below $100 million the lower middle market. No matter how you define it, however, there is nothing "middling" about the middle market: the depth of the market has attracted new financing sources year over year with traditional banks, finance companies, private credit funds, and others competing to underwrite deals in the space.

Middle market financing differs from bulge bracket or the more broadly syndicated institutional loan market in some key ways:

- Comparable market precedents tend to drive large cap deals because the distribution model of large syndications is to sell again what the market has most recently bought. Deal terms evolve and a new floor for the market is set as syndicated precedents are established. Middle market financings, on the other hand, are usually not widely syndicated since many are single-lender or small-group deals. Most middle market lenders use a buy-and-hold strategy, not a distribution model. As a result, terms in middle market deals are more tailored to borrowers and their businesses than to the wider syndicated market.
- While the high end of the middle market may have a high-yield or institutional-term loan component, the bulk of middle market deals do not. Layered financing in the middle market is usually done through first/second lien structures, unitranche, first/last out waterfalls, or other junior risk arrangements. So, intercreditor arrangements can be more complex in the middle market than the third-party subordination arrangements often found in large cap deals.
- Middle market deals tend to have lower leverage and more robust covenants than large cap transactions. While large cap deals are mostly covenant lite and use incurrence rather than maintenance financial tests, the majority of middle market deals have at least one or two quarterly maintenance tests (usually leverage and fixed charge or interest coverage) in addition to tighter baskets and covenant and default thresholds.
- EBITDA and other financial terms tend to be less complex in the middle market. Some of the more ambiguous add-backs to EBITDA, such as synergies and future cost savings, are either not present or are more limited in amount and duration through lender approval requirements and/or dollar or percentage caps.
- Private equity sponsor-based middle market deals tend to have a larger percentage of equity for the deal capitalisation than large cap sponsor deals. That's why middle market deals initially have more loan-to-value cushion than jumbo deals.

Credit providers in the middle market include large financial institutions, regional and super regional banks, finance companies, business development companies (BDCs), and private credit funds. Private credit funds account for the most new entrants in this space and there are now more than 800 operating globally.

Private Credit Landscape

Private credit was once viewed as an alternative to bank lending for smaller deals or riskier credits that traditional financial institutions would not underwrite. Early private credit deals were smaller, had more covenant control and carried a shorter maturity, and provided higher margins and fees than traditional bank-funded deals. Following the last financial crisis, as banks pulled back from the markets, private credit stepped in. Private credit is now mainstream and it is fuelling deals all over the world. The days of private credit being referred to as "shadow banking" are long over.

A number of factors have contributed to this growth:

- investors at all levels, looking for steadier returns and lower default rates than from alternative investments, are investing with private credit managers;
- borrowers are drawn to private credit because of the relatively nimble credit and execution process compared with traditional banks; and
- private credit offers one-stop shopping for both debt and equity products and allows financing at all levels of the balance sheet thanks to less regulation and streamlined investment decisions.

These considerations and others, including the migration of bankers and their relationships into the private credit world, have all contributed to the rapid growth of private credit as a primary source of capital today.

Trends

Here are some trends to note at the dawn of the decade:

- **Relaxing Debt Terms**. As private credit has become more competitive, deal terms have relaxed and a borrower's market has emerged. In the middle market, maintenance covenants are still the norm (unlike the covenant lite structures that form the bulk of widely syndicated transactions), but basket exceptions, loopholes, covenant level grower concepts and looser EBITDA definitions have made terms more favourable for borrowers. Lenders are responding to this trend and to concerns about the economy as a whole with increased diligence and credit analysis. Covenants are never a substitute for credit analysis, but with the safety net of covenants shrinking, private credit managers with more resources for market and credit diligence will have an advantage. *Also, in light of all the dry powder available for investment and additional competition from new entrants and growing funds, there will be a temptation to relax credit standards and to chase investments. Having fully developed internal credit controls and workout and restructuring expertise – either in-house or with trusted advisors – will be increasingly important. While the last down credit cycle set the stage for private credit to grow quickly, the next cycle will find lenders fully funded in a market that will need creative solutions to keep up returns.* Given investor concerns about the economy, having workout expertise in place will also help with fundraising. Now, more than ever, credit analysis and workout expertise should be a priority.
- **Distressed Debt**. Distressed investing was a successful asset class for raising funds in 2019. According to *Private Debt Investor*, private credit lenders who focused on this strategy raised close to $60 billion – more than a third of the total funds raised last year. *General concerns about global economic conditions are likely driving this pivot, underscoring the need for private credit funds to bolster their capabilities in distressed situations.* Lenders focused exclusively on distressed debt are still in the minority and, while default rates remain low, new money lending as well as subordinated and mezzanine lending are still popular. But there are signs that the winds could be shifting.
- **Protecting Investments**. As covenants relax, it is vital to focus on the terms that will protect lenders in a downturn or workout scenario. *Here the mantra is "liens and leakage". It will require particular focus to maintain the covenants that protect collateral and limit distribution of value away from obligors.* Terms that restrict liens and senior/pari passu debt, and "ring fence" value in the credit group (such as covenants on non-obligors, investments, distributions and dispositions, transactions with affiliates, etc.) will require even greater scrutiny. By the time a credit has shifted to a workout posture, financial and other covenants will already have been breached. Keeping the covenants on liens and leakage intact are essential to maintaining a strong footing and preserving options to deal with a restructuring.
- **Expanding Market**. We have focused on the core middle market, but private credit has expanded both down and up the scale with more than a third of deals at the $25 million EBITDA level and around a fifth at $75 million EBITDA and above. If the economy turns, we would expect new originations to focus on the low to middle market, where the relatively small size of the deal makes it easier for single lenders and small groups to generate financing. *If markets stay robust, however, we expect that with the amount of dry powder available for investment, private credit lending in larger deals will increase—both as a participant and a lead.* Deals above $1 billion, however, will likely continue to be the province of banks because of their access to funds and the relatively efficient cost of those funds.
- **Working Capital Facilities**. Revolving credit facilities will continue to be a challenge for private credit since most managers are equipped only for term debt investment. To provide more liquidity to borrowers, many private credit deals have relied on overfunding a term facility at close or on providing a delayed draw term facility. Those solutions, however, do not work as well as working capital line and letter of credit capacity. For those situations, the term facility needs to accommodate a true revolver, usually provided by a commercial bank. In one common structure, an asset-based lender (ABL) provides the revolver with that facility secured first by current assets, with the term lenders taking the long-term assets as first lien collateral; both facilities have crossing second liens in the primary collateral of each other. *Private credit lenders with revolving partners in place and existing agreements on a standard approach to the various intercreditor scenarios are at an advantage in the marketplace – they can offer a more efficient process to their clients. The intercreditor issues can be complex (and expensive) if worked through during a deal. Having those issues resolved and "pre-baked" is preferable for all parties.* Any downward turn in the economy will exacerbate borrowers' liquidity concerns, so having a structure in place now is important to stay competitive.
- **Unitranche & Senior Stretch Facilities**. Many private credit deals over the years have used unitranche structures. Under a unitranche, there is one loan made to the borrower, secured by all collateral, while a separate agreement among lenders sets forth collateral priorities and first-out, last-out waterfalls for the lenders. The unitranche approach provides blended pricing with less documentation. This is different from the typical 1st lien/2nd lien structure with its separate documentation and liens. Similar to unitranche, "senior stretch" loans have also entered the market. Under a senior stretch the lender provides additional senior loans at a higher leverage multiple (and higher coupon) with a senior last-out position in the waterfall. *The unitranche and senior stretch structures, however, have not been fully tested in bankruptcy. Given the single-document, single-lien approach of these structures, there is risk that any collateral value shortfall will result in the entire credit being split among secured and unsecured lenders – instead of the value breaking in the junior/last out position.* If economic conditions worsen, unitranche and senior stretch structures and pricing will bear watching.
- **Global Expansion**. North America continues to be the largest market for middle market lending and private credit

transactions and it is expected to continue to lead in deals done and funds raised. In the U.S., the majority of deal capital in the middle market is funded by private credit. In Europe and Asia, banks continue to hold the majority but the gap between banks and private credit is narrowing. In Europe, the UK is the largest market, followed closely by France and Germany. 2019 marked a strong year for direct lending in Europe with fundraising and deal volume up significantly. While Brexit has yet to affect the market, we expect that may change in 2020. Growth in Asia has varied by region because of different debt and insolvency legal regimes; multiple business and credit cycles across the continent have also made establishing cross-border products difficult. Still, country by country, private credit is growing across Asia. *An increase in distressed investing strategies and situations will continue to favour growth in North America and Europe, where rules for insolvency, protections for lien priorities, and limitations on leakage of value out of credit groups are well established.*

- **<u>Fund Finance</u>**. An increasingly popular tool among private credit managers, fund finance enhances returns by providing leverage based on (i) the quality of undrawn commitments from investors in the fund (subscription facilities), (ii) the net asset value of the portfolio investments of the fund (NAV facilities), or (iii) a combination of the two (hybrid facilities). Fund financing products have permitted private credit managers to increase their options when competing for deals and to better manage overall returns for their investors. These products do come at the cost of increased leverage and risk if default levels rise and ratings decrease. If portfolio values decrease or investors balk at providing additional capital, the lenders who financed those components of the fund's borrowing base need to be repaid before other investors. *It remains to be seen how concerns over the economy will impact fund finance structures, but we would expect the borrowing base elements and covenants to be adapted to provide more cushion for lenders against the risk of a downturn.*
- **<u>Consolidation</u>**. Just as we have seen banks consolidate over the last several decades, we expect some consolidation of private credit lenders and portfolios. A downturn in the markets will likely accelerate this process.
- **<u>Regulation</u>**. The regulatory landscape in the U.S. and around the world is shifting. While there have been rumblings of more reform, private credit has not yet come under traditional bank regulatory control. But the increased importance of private credit to the global markets may change this. If economies turn and there are more defaults, there will be call for more regulation. Private credit has been repackaged through CLOs and other platforms – like all debt – and the interdependency of the markets and various debt-related vehicles is complex. *If history is any judge, a southward turn in the markets will bring regulatory review and we would expect private credit not to be immune from that.*

Conclusion

While concerns about the future of the boom cycle are widespread, the middle market has proved to be resilient in down cycles. Given the proliferation of sources for lending and overall liquidity, we expect deal activity and fundraising to continue apace and for lenders to be able to shift to workout posture as needed. The increased focus of investors on distressed opportunities underscores the need for lenders to be (i) flexible in finding returns in good and bad money situations, and (ii) able to pivot as needed. The middle market lenders with superior resources for credit diligence, liquidity options, and workout capacity are likely to be the ones who find chairs if – and when – the music stops.

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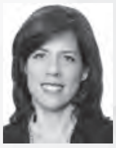
The Section 363 Sale & Acquisition Financing Process: Key Considerations from a Buyer's Perspective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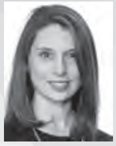
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1 Introduction

While sale processes under chapter 11 of the Bankruptcy Code ("Chapter 11") may seem similar to any other asset sale or acquisition processes outside of bankruptcy, executing a successful deal in the bankruptcy context is anything but simple. Indeed, acquisition financings in connection with a section 363 sale under the Bankruptcy Code (a "363 Sale") contain all of the same elements as financings of typical acquisitions outside of bankruptcy, but the bankruptcy process raises additional issues and makes these transactions uniquely challenging.

In this article, we focus on acquisition financing in connection with 363 Sales from a buyer's perspective. We begin with an overview of the 363 Sale process, which provides important context for thinking about negotiating and executing acquisition financing transactions. We highlight practical considerations of advising on acquisition financings in the context of 363 Sales, including the dynamics of negotiating with prospective lenders when the target is a distressed business, navigating Bankruptcy Court processes and their impact on deal timelines, managing lenders' enhanced due diligence demands and limiting concerns regarding conditionality.

Chapter 11, broadly speaking, is a form of bankruptcy that allows the reorganisation of the business affairs, assets and debts of a distressed company, where a company can reorganise through the sale of some or all of its assets during the case. Under Chapter 11, there are two methods for acquiring assets out of Chapter 11 for an interested buyer: a buyer can acquire certain assets and liabilities through a 363 Sale; or it can complete the acquisition through a plan of reorganisation. There are benefits and risks to each approach, and the decision as to which path to pursue depends on a variety of factors, including:

- the size and complexity of the case;
- the financial condition of the debtor;
- whether the debtor has made progress in negotiating with its creditors;
- whether the debtor believes there is a clear path to file a viable plan of reorganisation that will be confirmed;
- the assets and the industry of the debtor;
- whether secondary considerations (such as the preservation of tax attributes) may be furthered by a particular transaction structure; and
- whether there is any competition among potential bidders for the debtor's assets or business.

Section 363 of the Bankruptcy Code authorises a trustee or a debtor to sell all or a portion of the debtor's assets and is designed to allow such sale to take place expeditiously. The sale of a significant portion of a debtor's assets or business operations typically is considered to be a non-ordinary course transaction that would require the approval of the Bankruptcy Court. In order for a Bankruptcy Court to approve a 363 Sale of all or substantially all of a debtor's assets, the court must find that there is a "good business reason" for the proposed sale. The court will usually find a "good business reason" to exist when the value of the relevant assets is declining such that any value for the creditors would be lost or greatly diminished if the debtor continued to operate the business, when a debtor's operating expenses are exceeding its revenues (i.e., the "melting ice cube") and/or where the debtor lacks funding to continue to preserve its assets or operate its business for an extended period of time absent a quick sale. In each such situation, it is in the best interest of the creditors to permit the debtor to pursue and complete a sale transaction early in the case rather than to allow significant value leakage while the debtor attempts to develop and confirm a plan of reorganisation or force the debtor to wind down and liquidate its assets on a non-going concern basis.

Whether a buyer and a debtor decide to move forward with a 363 Sale or a sale consummated through a plan of reorganisation, the debtor and its creditors will value certainty that a deal will close when comparing bids that otherwise have similar value to the debtor's estate. As with any leveraged acquisition, if one potential buyer's bid has more certainty than another, the bid with more certainty will be more appealing to the seller, and how a buyer plans to finance the transaction and certainty of funding are always key factors. The finance plan and certainty of funding become even more important if the bankruptcy auction process is competitive.

2 Practical Considerations in 363 Sale Acquisition Financings – A Buyer's Perspective

Deal Dynamics: Negotiating with Prospective Lenders

A potential buyer in a 363 Sale process should expect that negotiations with the potential lenders in a 363 Sale process will be more challenging than in negotiations in connection with a standard leveraged buyout. There are many reasons this is the case, including: (i) the actual or perceived financial distress of a debtor; (ii) the lenders potentially having less familiarity with bankruptcy generally and the 363 Sale process; (iii) the actual or perceived risk of lending to a business that will be emerging from bankruptcy, including the likelihood such business can remain a "going concern" after closing; (iv) residual "hard feelings" that the lenders may feel if they are current creditors of the debtor; and (v) the uncertainty of whether the debtor's business will be sold as a going concern through the bankruptcy auction process or whether the debtor's assets will be liquidated.

When negotiating with the lenders, there is a chance, depending on the projected financial condition of the acquired business after the conclusion of the 363 Sale, that the buyer will have minimal leverage to negotiate amendments to the financing put in place. As such, it is essential for the buyer to have a clear understanding of what flexibility the business will need to operate successfully post-closing and, based on such understanding, develop a clear list of priorities or "must haves" to obtain as deal terms when negotiating with the lenders up front. To that end, developing a viable business plan will be an important element of structuring the post-bankruptcy capital structure and may be a requirement by the lenders (one that goes beyond a typical sponsor model and quality of earnings report). As buyer's counsel, it is important to understand the business plan to ensure that flexibility to implement it is permitted in the definitive documentation for the financing.

One way to evaluate the go-forward needs of the acquired business is to refer to the debtor's prepetition financing agreements, which in most cases will be used as the basis for the post-bankruptcy financing documentation. As a general matter, the post-bankruptcy financing documentation will have similarities to the prepetition financing agreements, but with more restrictive terms, including potentially more onerous reporting covenants, more restrictive negative covenants (especially with respect to permitted debt, liens, investments and restricted payments), less generous cure periods for certain events of default and tighter financial covenants with less favourable definitions.

Lastly, unlike standard asset sales, 363 Sales are approved by a Bankruptcy Court and conducted in accordance with court-approved bidding and auction procedures, which may add a level of complexity to the transaction and enhance the need for coordination between teams representing the buyer to further a successful transaction. It can be helpful to involve the buyer's M&A and bankruptcy advisors directly in conversations with the lenders and their counsel to help get them comfortable with the transaction structure and the elements imposed on a 363 Sale by the Bankruptcy Code and Bankruptcy Court.

From Bidding to Closing: Bankruptcy Court Processes and Deal Timelines

The stages of reaching an agreement in a 363 Sale scenario are generally similar to the stages of reaching an agreement in a standard leveraged acquisition: (i) a buyer submits a bid to the target; (ii) if the buyer's bid is appealing to the target, the parties will work to finalise the acquisition agreement and the buyer will work to sign financing commitments simultaneously with the signing of the acquisition agreement; and (iii) once signing takes place, the parties will work toward closing (which will include the definitive financing documentation).

In a leveraged acquisition outside of bankruptcy, the deal timeline may largely be driven by the need for regulatory approvals for the acquisition and marketing requirements for syndicated debt. Lenders and their counsel are familiar and comfortable with these processes. In a 363 Sale, the path from bidding to closing can be more fluid and subject to change as a result of specific elements of the Bankruptcy Code that determine when and how a transaction can proceed.

- **Sale Motion and Bidding Procedures.** The bankruptcy sale process is commenced by the debtor's filing a motion to approve the sale of its assets and the assumption and assignment of its designated executory contracts and unexpired leases (if any). The sale motion also typically will seek approval of bidding and auction procedures. Such bidding procedures impose the conditions for potential purchasers to be able to undertake due diligence and require a bidder to become a "qualified bidder", including by providing evidence of its financial ability to consummate a transaction. The bidding procedures also provide a deadline for bidders to submit a binding bid for the assets (including an asset acquisition agreement) and an auction if multiple bids are received. If the debtor is able to negotiate an acquisition agreement with a purchaser prior to the approval of formal bidding procedures, the debtor may in its sale motion seek approval of that agreement as a "stalking horse" agreement, subject to the receipt of higher and better bids at auction.
- **The Sale Hearing.** In order for a 363 Sale to move forward, the sale to the buyer selected by the debtor, including the winning bidder at an auction, must be approved by the Bankruptcy Court, where a sale order is entered formally approving the transaction. There are two types of sale hearings: an uncontested sale hearing and a contested sale hearing. Where all creditors and parties in interest support a transaction, and no other objections have been filed with the Bankruptcy Court to the proposed sale, the approval of the sale is fairly straightforward and usually involves a single hearing at which the judge approves the sale and enters a sale order. The simplicity and predictability of an uncontested sale hearing makes the transaction easier from a financing perspective because the sale terms are unlikely to change and the parties can plan for a closing on a predictable timeline. On the other hand, a contested sale hearing usually requires much more time and work and is much more unpredictable. A contested sale hearing occurs when objections to the sale have been asserted from one or more parties, which can include the unsecured creditors' committee appointed in the case or other *ad hoc* committees of creditors, contract counterparties (if the sale order includes the assumption and assignment of their contract) and counsel to various landlords (if leases are involved), among others. Because approval of the sale order will be a condition to funding under the financing agreements and the lenders will have agreed to finance the transaction on its negotiated terms, the resolution of objections to the sale, whether by the court following one or more hearings or by negotiation with the objecting parties, will be important to a successful completion of the sale and keeping the financing intact.
- **The Sale Order.** In addition to the acquisition agreement that governs the sale transaction, the sale is consummated through the entry of a sale order by the Bankruptcy Court. The sale order approves the sale transaction and specifically memorialises the court's approval and authorisation of (i) the acquisition agreement, as well as any ancillary documents, such as any transition services agreement or any employee lease agreements, (ii) the acquisition consideration (including the method (i.e., cash and/or credit bidding, if applicable) and whether it is being allocated among specific assets), (iii) the sale of the assets to be purchased free and clear of liens, claims, interests and encumbrances of the debtor, and (iv) the assumption and assignment of certain executory contracts and leases (if any) to the purchaser at closing. Entry of the sale order by the Bankruptcy Court is extremely important for a 363 Sale to close, as it authorises the debtor to complete the sale. The entry of an order satisfactory to the purchaser is normally a closing condition in the acquisition agreement and under the financing documents.

Enhanced Scrutiny: Lenders' Due Diligence

In every acquisition financing, the lenders will conduct due diligence on the target company – the amount of due diligence will vary depending on the lenders' existing knowledge of the target company, the financial condition of the target company and the type of transaction (i.e., an asset deal may require more due diligence by the lenders since the structure is inherently more difficult than a stock deal). The due diligence of the lenders in connection with a 363 Sale is often very extensive. Some of the points that lenders will want to understand fully are:

- what assets are being acquired and what assets are being left behind (if any);
- the liabilities the buyer is assuming;
- the consideration used to purchase the assets and whether any cash equity contributions (as opposed to proceeds of debt) will be injected into the targeted company once it emerges from bankruptcy;
- the substance of the sale order;
- any additional debt that will be incurred by the buyer at or after closing;
- the projected cash flows and *pro forma* financial statements of the buyer;
- any working capital needs; and
- any letter of credit or other credit support requirements.

While some of these items are similar to diligence a lender would conduct in a leveraged acquisition outside of bankruptcy, the first four items above are particularly important in the bankruptcy context and each have unique elements specific to 363 Sales:

- **Assets**. In 363 Sales, a buyer often has the ability to purchase "designation rights". Designation rights allow a buyer to cherry pick through the debtor's assets for a certain period of time after closing takes place and receive such assets without paying any additional consideration. Any assets of the debtor can be the subject of designation rights, but designation rights most frequently apply to leases and executory contracts that can be assigned to the buyer or rejected by the debtor. The benefits of designation rights include the ability to renegotiate contracts with landlords and other counterparties for more favourable terms and the opportunity for the buyer to conduct additional post-closing diligence. Designation rights are important to lenders because there are potential implications as to the collateral securing the lenders' debt and, depending on the assets and timing, the operations of the debtor's business. If designation rights are included in a transaction, it will be important to keep the lenders apprised of any changes in the acquired assets, which may involve sharing updated schedules to the acquisition agreement or other transaction documents on an ongoing basis.
- **Liabilities.** Lenders will be focused on understanding which liabilities will be assumed by the buyer at the closing of the acquisition. In the 363 Sale process, a buyer has the option to assume or reject certain liabilities. In some situations, a buyer will choose to assume certain liabilities of the debtor if they are going to continue to operate a line of business of the debtor. This provides additional value to the debtor's estate that other bidders who are buying selected assets cannot provide and which may be important for relationships in the go-forward business.
- **Forms of Consideration.** Lenders will want to fully understand the sources and uses of a 363 Sale, which can be different than in an ordinary acquisition. In a leveraged acquisition outside of bankruptcy, there are two types of consideration: debt and equity. In a 363 Sale, there are potentially three types of consideration: debt, equity and "credit bidding". Pursuant to section 363(k) of the Bankruptcy Code, a secured creditor has the ability to use up to the full amount of its outstanding debt to purchase any collateral securing that debt in a 363 Sale. A credit bid is not just consideration that can be lumped into a headline number, but rather it must be used to purchase specific assets that secure specific debt. Credit bidding gives a buyer a substantial advantage over any competing bidders, as it allows a buyer to offer a higher purchase price, if necessary, since part of the consideration is really secured claims on certain assets rather than cash. The secured creditor must hold first lien debt or pay in full all senior creditors to credit bid unless it reaches a different agreement with the other more senior creditors.

  From a lender's perspective, (i) credit bidding can create uncertainty if there are disputes about the validity of the debt being used to credit bid or as to the allowed amount of the creditor's claim, or if the value attributed to the credit bid changes, and (ii) credit bidding can be very complex if there are different tranches of debt with different co-lenders of varying seniorities.
- **The Sale Order.** Lenders and their counsel will want to have the chance to review, understand and comment on the sale order. It can be efficient to connect the bankruptcy team for the buyer directly with counsel to the lenders to walk through the sale order to address any comments or questions. The lenders particularly will want to ensure that: (i) the sale order approves the sale and assignment of the material assets to the business; (ii) the order finds that the debtor owns the assets and is able to deliver them to the purchaser; (iii) the sale is delivering the assets free and clear of liens, claims and encumbrances and that sufficient notice has been provided to parties in interest of the sale; (iv) that the sale consideration is fair consideration; (v) the sale and auction process has been robust and the sale is the highest and best use of the debtor's assets; (vi) the purchaser is a purchaser in good faith (which limits the risk of a later challenge to the sale); and (vii) there has been no collusion with other bidders or other parties. The lenders also will want to ensure that the sale agreement terms cannot be modified without the purchaser's (and effectively the lenders') consent.

Heightened Concerns of Conditionality

As with any other acquisition financing, conditionality in the commitment documentation is extremely important and will be most important to the debtor when evaluating the viability of the bid. While the conditions to funding in leveraged acquisitions outside of bankruptcy have become rather standardised in recent years, the conditions to funding in 363 Sales will very much depend on the circumstances of the deal. As a rule of thumb, one should generally expect the conditions in the commitment papers for a 363 Sale to be more robust. While some of these additional conditions will be related to the bankruptcy process generally, there are other conditions that lenders will insist on in the financing agreements due to the financial condition of the debtor or the business being acquired.

Generally speaking, one should expect the standard closing conditions of an acquisition financing, including those relating to: (i) equity contribution and control; (ii) receipt of proceeds from other debt; (iii) no material adverse effect; (iv) all specified acquisition agreement representations and specified representations are true and correct in all material respects; (v) all lender fees have been paid (including reasonable and documented attorneys' fees); and (vi) information has been provided to satisfy know-your-customer laws. However, there are a few differences and additional conditions that may arise in negotiations with lenders in connection with a 363 Sale:

- **The 363 Sale Shall be Consummated in Accordance with the Terms of the Executed Acquisition Agreement.** While this condition is common across acquisition financing transactions, the difference with a 363 Sale is that this condition also includes a consent right for the lenders if the assumption of any liabilities is in excess of those disclosed in the acquisition agreement or if there are certain changes to the terms of the sale order from the exhibit attached to the acquisition agreement at signing. Consent rights are triggered in connection with changes to the sale order if such changes impact the following: (i) the sale of the acquired assets to the buyer free and clear of all liens, claims, and liabilities pursuant to section 363(f) of the Bankruptcy Code; (ii) findings that the buyer is a "good faith" purchaser within the meaning of section 363(m) of the Bankruptcy Code and granting buyer the protections of section 363(m) of the Bankruptcy Code; (iii) findings that there was no collusion by the purchaser with other parties; (iv) findings that the consideration provided by the buyer for the transaction constitutes fair consideration and reasonably equivalent value; or (v) any other findings or terms of the sale order that the lenders determine, in their reasonable discretion, are adverse to any of the lenders.
- **Delivery of Financial Statements**. As with many acquisition financings, financial statements will be required to be delivered to the lenders prior to signing and/or closing the transaction. However, the requirement to provide *pro forma* financial statements and other financial information as a condition to funding can vary depending on the type of transaction, the target company and the presence of a private equity sponsor. In 363 Sales, it is highly likely that, as a condition to funding, the buyer will be required to provide the lenders with *pro forma* financial statements of the buyer entity and its subsidiaries prepared after giving effect to the transactions as if the transactions had already occurred. While a buyer bidding for a debtor with a strong operating business may try to resist this condition, it is unlikely to be successful.
- **Marketing Period.** While a marketing period condition is common in most syndicated bank deals, the coordination of a marketing period in a 363 Sale can be challenging. 363 Sales often move very quickly. Under the Bankruptcy Code, a 363 Sale can close as soon as 15 business days after the Bankruptcy Court approves the transaction (once the sale order becomes a final non-appealable order). However, the Bankruptcy Code also permits the court to permit the parties to close prior to the expiration of the appeal order, which courts regularly do when the parties show the court that value will be lost if the sale does not close immediately, and in certain instances sales have closed within a few days after the sale order was entered. Notwithstanding the foregoing, if committed financing is syndicated, lenders may insist on having a marketing period. When financing a 363 Sale with a marketing period, timing must align with the bankruptcy process and timeline. The bankruptcy team for the buyer should be involved in these discussions, bearing in mind the debtor will want a purchaser to have an unconditional bid prior to the court approval of the transaction.
- **The Sale Order.** For a 363 Sale, lenders will want to include a closing condition stating that the Bankruptcy Court has entered into the sale order and such sale order is in full force and effect and shall not have been stayed, vacated or modified. This should also be a closing condition in the acquisition agreement. So long as the language is consistent in the conditions, it should not be a point that is controversial to a buyer in most instances.
- **Liquidity.** In acquisition financings in connection with 363 Sales, there may be a condition to funding regarding sufficient liquidity at the company after giving effect to the acquisition, which would be unusual in a leveraged acquisition outside of bankruptcy. Such a condition would refer to liquidity within the *pro forma* structure, so cash held by the parties to the financing agreements after giving effect to the transactions. This can include cash proceeds of the debt financing, as cash on hand at the debtor will likely not be transferred to the buyer as part of the acquisition. Including this condition is very much dependent on the financial situation of the debtor and whether the lender has confidence in the buyer's ability to turn the business around.

3 Conclusion

In conclusion, while acquisition financing in connection with a 363 Sale may seem fairly consistent with acquisition financing outside of bankruptcy, lenders and purchasers should prepare for the additional procedural requirements in a 363 Sale and the additional financial considerations and deal points to be negotiated. As the process moves along, the parties will need to be nimble, as the deal may move at a rapid pace (perhaps faster than usual for a complex transaction outside of bankruptcy) and there can be structural changes, and negotiation of other deal terms as the process evolves. Flexibility, efficiency and coordination between the deal team and bankruptcy team of the buyer are extremely important to make sure the important and moving pieces are covered.

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Cross-Border Derivatives for Project Finance in Latin America

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1 Introduction

Project financing in Latin America continues to attract the participation of international lenders. Global banks are competing and investing substantial effort to finance power, renewable energy and infrastructure projects and negotiate the best possible terms in their loan documentation. Project financing, by nature, is non-recourse and involves leverage and, therefore, generally, the loan is required to have a corresponding interest rate protection agreement. The lender and borrower enter into an interest rate swap transaction, based on the notional amount of the loan, in which the lender, as the swap provider, makes payments on a floating rate of interest and the borrower makes payments on a fixed rate of interest and, thereby, hedges against upward rate movements. This article is a primer on loan-linked interest rate swap agreements and the general environment for loan-linked swap agreements in Latin America. It also highlights specific provisions in swap agreements which lenders may want to consider when negotiating their swap documentation.

2 How Are Interest Rate Swaps Documented?

For purposes of this overview, a description of the documentation for swap agreements is a good place to start. Typically, parties use either the standard 2002 ISDA Master Agreement or 1992 ISDA Master Agreement (Multicurrency – Cross Border), each of which may be governed by New York law or English law. The "ISDA Master Agreement" is published by the International Swap Dealers Association ("ISDA") and, for more than 20 years, has been used to document derivative transactions in the global markets. The advantage of using the ISDA Master Agreement is that because of its prolonged market-wide usage, it has led to the development of legal precedent upon which parties may look to when enforcing their rights.

The ISDA Master Agreement contains two sections: the "Master", a pre-printed form which sets forth the standard terms in the agreement. Attached to the Master is the "Schedule" in which the parties specify their elections with respect to the standard terms in the Master. The ISDA Master Agreement is supplemented by a "Confirmation" in which the parties record the economic terms of a specific transaction which, in the case of an interest rate swap may include the notional amount, trade date, effective date, termination date, notional amount, fixed rate payer and payment dates, floating rate payer and payment dates, day count fraction and reset date, among others. In addition to the ISDA Master Agreement, ISDA publishes standard definitions which the parties incorporate into their Confirmations.

The 2002 ISDA Master Agreement (Multicurrency – Cross Border), governed by New York law, is the more commonly used form of agreement for loan-linked swaps and the 2006 ISDA Definitions are the definitions more commonly used in the Confirmation. However, in Latin America, there may be exceptions to parties' use of the ISDA Master Agreement. For example, if the parties to the swap transaction are domiciled in Mexico, they might use the local Mexican law-governed derivatives contract (*Contrato Marco para Operaciones Financieras Derividos* or "CMOF") or, if domiciled in Brazil, they might use the local Brazil law-governed derivatives contract (*Contrato Global de Derivitos* or "CGD").

3 Are Interest Rate Swap Agreements Enforceable in Latin America?

Project lenders engage counsel to help negotiate and draft the loan documentation. Lenders' counsel works closely with local counsel to address issues such as perfection of a security interest and enforcement in the event of a borrower insolvency. It is equally beneficial for lenders, acting in their capacity as swap providers, to engage derivatives counsel to help negotiate and draft the ISDA Master Agreement. In Latin America where the laws vary from country to country, from free open market to highly restrictive, it is critical that the legal team help mitigate against the risk of running afoul of local laws and regulations with respect to both the loan and the ISDA Master Agreement. Jurisdictions in Latin America may have laws and regulations which are complex and untested and the legal processes may be lengthy. For this reason, the importance of engaging local counsel cannot be overstated.

It is generally the case that the more developed the rule of law in a country, the more likely it is that the local courts will respect the terms of the ISDA Master Agreement and not interfere with the non-defaulting party's right to terminate. In the event of the insolvency of the local party (provided that it is a corporate entity), the laws of many jurisdictions provide for automatic termination upon insolvency but, again, because the laws differ in each country, derivatives counsel, working with local counsel, should be consulted.

With respect to the enforceability of the ISDA Master Agreement, ISDA maintains a library of published legal opinions for use by the members of ISDA which it commissions from prominent law firms in various jurisdictions, including Argentina, Brazil, Chile, Colombia, Mexico and Peru. Local counsel opines on matters such as enforcement against collateral, netting and close-out of positions upon insolvency and, in some cases, the enforceability of termination provisions in the ISDA Master Agreement. The ISDA opinions are updated annually, or more often if there is a significant change in law. Each opinion is based on various assumptions including, but not limited to, the type of legal entity which the local party is and whether the ISDA Master Agreement is subject to New York or English law.

4 What Are Potential Documentation Risks in Swap Agreements?

Crystallizing the Termination Value of the Swap

The ISDA Master Agreement and financing documents have many attributes in common but, fundamentally, the dynamics of their provisions may differ. They typically both include provisions for payment, representations and warranties, covenants, tax provisions, events of default and remedies and other miscellaneous terms. In the ISDA Master Agreement, there are "Events of Default" for failure to pay, breach of agreement, credit support default, misrepresentation, default under a specified transaction (i.e., a transaction under another agreement between the parties), cross default, bankruptcy and merger without assumption (the surviving entity does not assume the obligations). There are also "Termination Events" for illegality, tax event, tax event upon merger, credit event upon merger and, in the 2002 ISDA Master Agreement, *force majeure*. The loan documentation provides for acceleration of the loan but also may include provisions for waiver, amendment, supplement, repayment, prepayment, or refinancing of the loan. Such terms enable open-ended timeframes for the parties to negotiate changes.

The ISDA Master Agreement differs markedly from the loan documentation in that it has extremely short grace periods. For example, in the 2002 ISDA Master Agreement, the grace period for failure to pay is one "Local Business Day" and, for dismissal of an involuntary bankruptcy, it is 15 days. The ISDA Master Agreement must be especially time-sensitive so that a non-defaulting party will avoid potentially significant termination costs. Interest rate swaps transactions are *marked to market* and, as such, their value fluctuates based on factors including, but not limited to, reference rate, credit spread, volatility, currency risk, political events, tenor and notional amount. Liquidity is another key factor which may impact the swap price. The higher the risks to finance a project in a particular jurisdiction, the less liquid the market will be for pricing the related swap. Thus, if, for any reason, a project begins to experience distress, it may adversely impact the value of the swap.

Notwithstanding the fact that the lenders "wear two hats" because they also act as swap providers, in their capacity as lenders, they possess the voting rights and exert central control over the financing. For this reason, they are generally unwilling to grant greater termination rights under the swap agreements than they do under the loan documents.

However, lenders can protect themselves against the risk of loss on their swaps by not agreeing to modify the grace periods in the ISDA Master Agreement. If hard pressed to compromise, they may consider drafting the ISDA Master Agreement so that they will have the right to declare an "Early Termination Event" and calculate the swap termination value ("Close-out Amount") but *not require the defaulting party to make payment* until the lenders decide to accelerate the loan. This loss prevention measure is referred to as "crystallizing" the swap price. In this way, they lock in the termination price of the swap when adverse circumstances first arise. Lenders should consider resisting any effort to modify or disapply their rights to declare an early termination under the ISDA Master Agreement.

Securing the Swap Obligations *Pari Passu* to Principal

The loan documents include provisions to secure and/or guarantee payment of the obligations for the loans. In the waterfall, the payment of principal ranks at the highest level following the payment of fees. Likewise, there should be provisions in the loan documents to secure and/or guarantee payment of the obligations for the swaps. In the post enforcement waterfall, the swap termination payments should rank equal in right and order of payment (*pari passu*) to payment of the principal.

Special care should be taken to ensure that the defined terms in the loan documents fully integrate references to: (i) the ISDA Master Agreement as a required and secured agreement; (ii) the obligations under the ISDA Master Agreement as secured obligations; and (iii) the swap provider as a secured party.

Preventing "Orphan" Swaps

If a lender ceases to be a party to the loan documents, there must be a mechanism to terminate the lender's swap. If the lender has been removed under the terms of the loan documents ("yank-a-bank" provisions), the swap should be terminated. If the lender exits the loan voluntarily, the sponsor may insist that the lender novate the swap. If that is the case, the lender should have the right to refuse any novation which (i) does not satisfy its requirements for Know Your Customer and onboarding, or (ii) which causes the lender to incur any cost or expense.

Additional Termination Events

Derivatives counsel typically includes in a loan-linked ISDA Master Agreement certain "Additional Termination Events" ("ATEs") which trigger termination of the swap if certain events occur. The term "Affected Party" means the defaulting party so that the Non-affected Party is the party which will calculate the "Close-out Amount".

Lenders may consider including the following ATEs in the loan-linked ISDA Master Agreement. In the example below, Party A refers to the lender and Party B refers to the borrower.

Each of the following events shall constitute an Additional Termination Event and Party B shall be the Affected Party:

(1) If the Credit Agreement (as defined below) expires, terminates or is cancelled, whether by reason of payment of all indebtedness incurred thereunder or otherwise (including in the event of a refinancing).

(2) If the Credit Agreement ceases, for any reason, to be in full force and effect.

(3) If Party A ceases to be a Lender under the Credit Agreement.

(4) If Party B's obligations to Party A under this Agreement cease to be equally and ratably secured with Party B's obligations to the Lenders pursuant to the Credit Agreement.

(5) If Party B agrees by amendment to the Credit Agreement or otherwise to pledge, assign, or otherwise transfer collateral of any kind to or for the benefit of the lenders to secure its Obligations under the Credit Agreement and fails at the same time to equally and ratably secure its obligations to Party A hereunder in form and substance acceptable to Party A.

Other Terms

The parties specify in the Schedule to the ISDA Master Agreement whether cross default or cross acceleration will apply and, if so, the amount at which a default will trigger cross default or cross acceleration. This amount, the "Threshold Amount," should be identical to the cross default amount in the loan documents.

5 Why Engage Derivatives Counsel?

Lenders engage derivatives counsel in the context of project financing for a number of reasons, the most obvious being the need for expertise in swap transactions and to work with local counsel, in order to harmonize the terms of the ISDA Master Agreement with local laws and legal processes. In addition, derivatives counsel and project finance counsel coordinate so that the negotiation, production and exchange of draft documents will be more efficient. In cases where the project sponsor is working with a non-legal advisor, the expertise of derivatives counsel is essential to ensure that the terms in the ISDA Master Agreement are harmonized with those in the loan documents and that any terms in the loan documents which supersede those in the ISDA Master Agreement are fully vetted and negotiated.

6 Conclusion

This article is intended to alert project lenders, that their loan-linked interest rate swaps can be affected when conditions arise which adversely affect their projects and if the risks are not addressed in their swap documentation, it is possible that their swaps could lose significant value. It is highly recommended that project lenders engage the expertise of derivatives counsel to draft an ISDA Master Agreement which is as robust as possible and to consult with local counsel regarding the laws of the jurisdiction, including those in Latin America, where the project is located.

Note

This article does not constitute a legal opinion related to any of the subjects or topics mentioned herein. The views and opinions expressed in this article are those of the author and do not necessarily reflect the official policy or position of Credit Agricole Corporate and Investment Bank.

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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, despite 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 2019 have been: (i) the EUR 252 million loan from Caixa Geral de Depósitos, S.A. for financing the execution of works in the Naval Base of Soyo to the Angolan Government; (ii) the USD 320 million loan from Banco Internacional para a Reconstrução e Desenvolvimento under the materialisation of the Executive Programme on Human Development and Social Well-Being to the Angolan Government; and (iii) the USD 400 million loan from Gemcorp Capital LLP for financing the expenses incurred with the implementation of the project of the Laúca 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 the answer to 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 the answer to 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 the 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 the answer to 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, such security can be granted under a New York or English law governed document 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 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 the answer to 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): depend on the nature, complexity and value of the act to be executed;

(ii) registration fees: depend 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 the answer to 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 the answer to 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 the answer to 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 those 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 Angolan 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 the concept of *impugnação pauliana* (Paulian Action), pursuant to which an action could be brought by a creditor to set aside a transaction that results in a decrease of the bankrupt company's assets and in circumstances in which there was no consideration, provided certain requirements are met.

Preferential creditors' 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 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 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 the answers above fairly address the main material issues that arise generally in the context of lending transactions.

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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 2019 this progress has weakened. Nevertheless, growth rates in Austria are still above the European average and especially corporate loans have reached renewed momentum in 2019. Such rise is primarily attributable to the stable growth of 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 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 trading with such non-performing loans active, with the CESEE region being mainly responsible for non-performing loans in the portfolios of Austrian banks' subsidiaries.

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. In November 2018, the Austrian federal government decided to restructure the banking supervisory framework by bundling supervision over the financial market with the Austrian Financial Market Authority (FMA). This took effect on 1 January 2020.

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 increasingly important. The FinSG provides for wider and less regulated means of enforcement of the collateral and in particular 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 – it being reported that Vonovia's take-over is to a great extent debt financed. 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. Verbund AG placed a green promissory note via digital emission in the first quarter of 2018. 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. As sustainability is an issue with ever-increasing importance, the Österreichische Kontrollbank AG (Austria's central finance and information services provider for export and the capital market) issued its first Sustainability Bond with a volume of EUR 500 million in 2019. The net issue proceeds are being used in order to (re-) finance social as well as environmental 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)?

Downstream guarantees (or other security) are not restricted by Austrian law. Stringent limitations apply, however, 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 it must be specific and not only general, 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, 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 deemed void (*ex lege*). The company would then have a claim for repayment against the person or entity that has received the funds. 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 business man, 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 in order to create 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, was regulated in statutory law in 2015 (and was then amended in 2018) 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.

The following types of personal collateral for securing lending obligations are the most common: (a) assumption of debt (*Schuldbeitritt*); (b) sureties (*Bürgschaften*); (c) guarantees; and (d) letters of comfort (*Patronatserklärungen*).

The most common types of *in rem* collaterals used are the following: (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 pledge, basically requiring 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 does 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 the 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?

A mortgage is the only form of security over real property (land). A mortgage grants a right of preferential satisfaction to the pledger when the pledgee does not meet its payment obligations. It is necessary that a mortgage deed be agreed upon between the pledger and the pledgee. For perfection, the mortgage needs to be registered in schedule C of the land register. 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 (the point in time when the application for registration of the pledge in the land register reaches the competent land register). A mortgage can be registered for a fixed amount as a regular mortgage, including a certain percentage of the interest, interest on default, and a fixed amount of ancillary costs. Additionally, it is also possible for a mortgage to be registered with a maximum amount for loans granted. The secured obligations under such a mortgage can vary over the lifetime of the mortgage, with the amount actually secured being the outstanding amount owed by the pledgee from time to time. 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 to 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 to 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. In the case of a pledge, the pledgee will be granted preferential satisfaction out of the proceeds. On the other hand, however, in the case of an assignment, the assignee becomes the owner of the claim, holding it in trust for the assignor for security with the purpose of obtaining preferential satisfaction.

In accordance with the principle of speciality, the pledge can only be perfected in relation to a specific object (chattel). This means that it is impossible to grant a pledge over all of the assets of the debtor. Furthermore, the pledgee is obligated to keep the pledged chattel and prevent the pledger from further utilising it.

Under Austrian law, in general, no more requirements other 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 realisable (capable of satisfaction). 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, which are determined or at least determinable (i.e. if the parties and the legal reason of the agreement are certain), 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 or adequate markings must be made in the pledgor's records and accounts (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. Such shares are not evidenced by a share certificate. Therefore, for the perfection of the GmbH share pledge, notification to the managing directors 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 authorities or courts.

The Stamp Duty Act provides for a wide variety of documents, which 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 question 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?

Collateral that is accessory, such as sureties or pledges, must not be separated from the underlying secured obligation, otherwise the collateral will cease. 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 that the requirements of the accessory collateral are met, 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 regards 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 0.25% 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 a 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 contract 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 question 7.3 (a). With regard to question 7.3 (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 to 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 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 that 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. A valid licence is a prerequisite for conducting banking transactions. The licence for conducting banking transactions may have certain conditions and obligations attached to it, whilst parts of individual types of banking transactions may be excluded from the scope of the 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.
- Credit institutions authorised in an EEA Member State are in principle already authorised on the basis of their authorisation/licence in their home state to provide banking services in other Member States. Hence, a credit institute of another EU Member State may establish a branch based on the "EEA freedom of establishment" (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 the following: (i) improvement of transparency of real owners of companies and trusts by granting public access to the beneficial owner information in relation to companies and broadening access to the beneficial owner information in relation to trusts; (ii) the national beneficial owner registers of the Member States will be interconnected and cross-border verification mechanics will be implemented; (iii) the rules are expanded to additional "gatekeepers"; entities which provide services that are in charge of holding, storing and transferring virtual currencies will have to identify their customers and report any suspicious activity to the Financial Intelligence Units; (iv) Member States are forced to set up centralised bank account registers or retrieval systems to identify holders of bank and payment accounts; and (v) Financial Intelligence Units will have access to more information through centralised bank and payment account registers or data retrieval systems. 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 KYC 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

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1 Overview

1.1 What are the main trends/significant developments in the lending markets in your jurisdiction?

The new Belgian Code of Companies and Associations entered into force on 1 May 2019, bringing a fundamental reform of Belgian company law. The new Companies Code modernises and improves the flexibility of the Belgian rules governing both companies and associations. In the field of financing, amongst others, the rules on financial assistance have been simplified and change of control clauses no longer need the prior approval of the general meeting of shareholders, unless in the case of a listed company. The new Companies Code now also allows for the incorporation of a private limited company (*besloten vennootschap/société à responsabilité limitée*) without share capital (but with sufficient net assets in light of its activities) or the possibility of having only one sole shareholder in a limited company, which makes the law more flexible and allows for easier group structures.

On 1 December 2020, new rules on B2B unfair contractual terms will enter into force. For the first time, clauses in B2B contracts will be prohibited that are found to create an evident imbalance between the rights and obligations of the parties. Save for the general prohibition, a black list that prohibits certain clauses in all situations (e.g. the right to unilaterally interpret one of the clauses of the contract) and a grey list which includes clauses that are presumed to be prohibited, unless proven to the contrary (e.g. unreasonable damages for failure to perform), will be introduced as well.

These rules on B2B contracts will, for now, not apply to financial services, including B2B lending agreements. However, the new act foresees that a Royal Decree may declare some of these rules applicable to financial services. The parliamentary acts accompanying the new act indicate that this will rather happen in the near future, as this provision does not aim to exclude financial services entirely, but merely to let the financial regulators draft rules that take the particularities of the financial sector into account. Once declared applicable, new B2B lending agreements will have to be carefully reviewed for any clauses that may be incompatible with the new act.

1.2 What are some significant lending transactions that have taken place in your jurisdiction in recent years?

As there are no official reports on lending transactions in Belgium, we cannot comment on any specific lending transactions over the past few years. According to Febelfin, the Belgian association of the financial sector, outstanding loans for Belgian companies increased by 4% to EUR 162.6 billion by mid-2019 in comparison with a year earlier. Demand by Belgian companies for loans declined slightly by 4% in the third quarter of 2019, while banks issued 2.4% fewer loans. In general, the lending climate remains borrower-friendly, as lending conditions are favourable and interest rates remain relatively low, a trend which is also to be noted in the rest of the euro zone. According to the October 2019 Bank Lending Survey of the ECB, credit standards eased slightly for loans to enterprises in the third quarter of 2019 and demand for loans remained more or less unchanged, increasing slightly for SMEs and decreasing for large firms.

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: (i) any direct and/or indirect benefits the guarantor derives from the loan; (ii) the balance between the risk relating to the guarantee and the benefit for the guarantor; and (iii) 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 does not exclude) 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 listed 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 considerably influence the assets of the company or create a considerable debt or obligation for the company, whereby these 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 is 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 with 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 in the form of 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 on the entire business that must be registered with 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, although restrictions can apply in the articles of association or approval by a majority of the shareholders is required for certain corporate forms such as the private limited company. 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 within one hour. 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, none.

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
Under the new Belgian Companies Code, a company is allowed to grant financial assistance in the form of a loan, a guarantee or a security to secure a loan which shall or has been used to fund directly or indirectly the acquisition of shares of the company by a third party as long as: (i) the rights of the minority shareholders are not disregarded; and (ii) the continuity of the company is not jeopardised. Only funds that are eligible for distribution can be used to provide financial assistance. To avoid available funds not being 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
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.

(c) Shares in a sister subsidiary
See (b) 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, 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 yet exist 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 with the mortgage register. This requires a notarial deed.

A transfer of a registered pledge on movable assets must be registered with 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 and incentives 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 ("ATAD") on interest limitation have entered into force on 1 January 2020 for the tax year 2019 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: (i) any mandatory provisions of other jurisdictions; (ii) applicable EU law; (iii) overriding mandatory provisions of the jurisdiction in which the obligations arising out of the contract are performed; (iv) Belgian overriding mandatory provisions; or (v) 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 (are) registered with 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. attachment of 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, unless the trustee in bankruptcy requests that they are 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?

Under Belgian law, a party is allowed to choose any foreign jurisdiction as a forum for its dispute. However, under certain conditions, Belgian courts will nevertheless maintain exclusive jurisdiction (e.g. for disputes concerning rights *in rem* on immovable property located in Belgium or for overriding mandatory provisions). 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?

Save for those mentioned above, we do not find there to be any other material considerations to be taken into account.

Dieter Veestraeten has more than 20 years of experience in advising large Belgian and foreign banks, companies and multinationals in the field of international financial transactions (including acquisition finance, project finance, general corporate finance), debt transactions, restructuring and financial regulatory advice.
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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 45 fee-earners in total. 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.

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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 2019 affecting the rights of secured parties or Bermuda's reputation as a leading creditor-friendly jurisdiction.

In December 2018, Bermuda enacted economic substance legislation. Broadly equivalent legislation has been passed in all major offshore jurisdictions. The legislation requires certain entities that carry on business in a 'relevant activity' to comply with economic substance requirements, which may include being managed and directed in Bermuda. Lenders should obtain assurances from Bermuda counterparties engaged in relevant activities that they comply with their economic substance obligations, as non-compliance can result in substantial fines and ultimately a court order for strike-off.

Bermuda's Incorporated Segregated Accounts Companies Act 2019 came into effect on 15 January 2020. ISACs enable the creation of corporate group structures to operate multiple businesses or "accounts", each ring-fenced with its own separate legal identity, under one corporate body. Each account will have many of the attributes of a company, including the ability to hold assets, sue and be sued in its own name, and establish its own board of directors. It is expected that these structures will have applications in numerous sectors including insurance, investment funds, multinational enterprises, family offices, asset management and securitisation.

1.2 What are some significant lending transactions that have taken place in your jurisdiction in recent years?

2019 was a tempestuous year for lending transactions in the construction and real property development sectors, with several projects affected by uncertain economic times both in Bermuda and elsewhere. The most significant lending transactions that have taken place in 2019 were in financed holding and joint venture structures, which utilised a variety of secured lending arrangements.

One such significant lending transaction in the real estate sector during 2019 was the refinancing of a group of Bermuda entities owning a significant portfolio of commercial property assets in the United Kingdom. Another significant lending transaction involved the refinancing of the development of the luxury hotel and resort complex at Caroline Bay, Bermuda, by a syndicate of banks in cooperation with the Government of Bermuda.

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 honestly 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 either a legal mortgage (executed as a deed), where title is transferred to the mortgagee (or lender), or an equitable mortgage (executed under hand), where a charge is established without title being transferred to the mortgagee. Security is typically granted over plant, machinery and equipment by way of fixed charge or chattel mortgage.

Given that a legal mortgage involving real property transfers title to the mortgagee, such a mortgage has typically been executed subject to a requirement that title be transferred back to the mortgagor upon satisfaction of the underlying secured obligations.

When the Land Title Registration Act 2011 (**2011 Act**) came into effect on 2 July 2018, the grant of both a legal mortgage and an equitable mortgage came to trigger compulsory first registration of title to the real property forming the subject matter of the mortgage or charge and it became necessary to lodge the relevant mortgage or charge, as well as the balance of the title documents relating to the property in question at the Land Title Registry Office (**LTRO**) (as established in accordance with the 2011 Act).

Upon first registration, a mortgagee's priority position is now established on the property register. Priority is based on the date that an application for first registration is submitted to the LTRO. The 2011 Act also operates to automatically convert a legal mortgage into a registered charge (meaning that title is returned to the mortgagor by way of a statutory vesting and the mortgagee comes to own a registered charge (only), rather than title to the real property in question. This system replaces the historical regime, which required that any legal mortgage or charge be registered in the Book of Mortgages in order to protect a mortgagee's priority position.

While the new electronic title register that has been established in accordance with the 2011 Act is intended to replace title deeds (as evidence of ownership) most mortgagees are continuing to take possession of title deeds. This is because the detailed plans and other information that is included with the deeds has proven helpful (historically) in respect of resolving title-related challenges, and this continues to be the case.

Both legal 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 real property in Bermuda, including obtaining the prior consent of the Minister of Finance and the Minister responsible for Immigration respectively. If a mortgage taken by an overseas or exempted company is subsequently enforced, any land obtained by such company (as mortgagee in possession), must be sold within five years to either a person or entity having Bermudian status or to 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 acknowledgment.

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 (a) above.

(c) Shares in a sister subsidiary
See question 4.1 (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?

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 covers 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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1 Overview

1.1 What are the main trends/significant developments in the lending markets in your jurisdiction?

Bolivia's current situation and regulations regarding lending markets is the result of a series of legal dispositions that have been issued since 2014 and that remain in force today. 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 were 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 June 2019, Bolivian financial entities are reported to have fully complied with the goals (and to have even exceeded them) set by the aforementioned 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 2019, 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$ 25,781 million, an increase of US$ 2,412 million compared to 2018.

Loans Portfolio

As of December 2019, the loans portfolio closed at US$ 26,402 million, an increase of US$ 2,369 million compared to the end of 2018. Statistics also show that, as of June 2019, financial entities have reached and even exceeded their loans portfolio goals (more than 50% of their loans portfolio) set by specific regulations that have been issued in Bolivia since 2014.

Industrial, Commercial and Services Sector Portfolios

Up until December 2019, 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$ 19,469 million.

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 2019, the social housing sector portfolio in Bolivia reached US$ 6,932 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)?

In Bolivia, it is very common that companies within a corporate group secure loans of one or more other members of their 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.

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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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, such as:

- Stanbic Bank Botswana Limited BWP212,000,000 Tier II, Senior Unsecured Floating Rate Notes, maturing 28 November 2029;
- Botswana Housing Corporation BWP300,000,000 floating rate note due 10 December 2025 under its BWP2,000,000,000 domestic note programme;
- Stanbic Bank Botswana Limited BWP88,000,000 Tier II, Senior Unsecured Fixed Rate Notes, maturing 28 November 2029;
- Getbucks Botswana BWP5,000,000 fixed rate note due 23 March 2019 under its BWP500,000,000 domestic medium note programme; and
- Stanbic Bank Botswana Limited BWP2,000,000,000 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 depending on 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 is likely to have the effect of the company incurring 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]. Authorised creditors are listed under the Hypothecation (Authorized Creditors) Regulations.

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. On the other hand, 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 debtors 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. The procedure would ordinarily involve the parties entering into an agreement to effect the security over the cash deposits. The cession does not require registration and is not subject to conveyancing or notarial fees.

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. Shares in private companies are in certificated form while shares in public companies are in uncertificated form. 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 under 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 either 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 timelines 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 and listed as such under the Hypothecation (Authorized Creditors) Regulations. 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 certificate of incorporation of the company; a deed executed by a conveyancer; and the original title of the immovable property (for a mortgage bond).

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 are 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 enabling 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 [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. There are no taxes that apply exclusively to foreign lenders with respect to their loans, mortgages and 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. 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 under 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 Tax 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?

With regard to the first part of the question concerning the length of time it would take for a foreign lender to file a suit, the answer would depend on the agreement between the parties as to the time-frame from default to institution of proceedings. The parties can therefore provide for a grace period after default during which the company should pay, failing which the lender may then resort to filing a suit with the court.

There is no prescribed time-frame as to how long it would take for a foreign lender to 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 *parate executie* 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, and 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 Regulatory Authority (NBFIRA) is responsible for regulating and supervising Non-Bank Financial Institutions in Botswana. In terms of the Non-Bank Financial Institutions Regulatory Authority 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 local lenders who have not obtained the 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 or continues to occur. 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.

The NBFIRA Act does not provide the penalties to be charged against any person who trades without a licence. Some of the penalties for trading without a licence are found in different acts that are specifically designed for each non-bank institution. 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. The Acts do not specify any requirements on foreign lenders to obtain a licence in order to lend money to Botswana Companies.

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 establish a business of advertising or providing 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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Laurence Khupe Attorneys (inc. Kelobang Godisang Attorneys) is a result of a merger of two remarkable corporate firms of Laurence Khupe Consulting and Kelobang Godisang Attorneys. The merger created one of the leading corporate firms in Botswana. We are a boutique firm specialising in providing high quality legal services in the field of corporate law. We pride ourselves in bringing efficient solutions, risk management and practical value adding propositions to the work that we do.
Our lawyers are highly skilled and have extensive knowledge in their various areas of practice. The partners have a cumulative experience of more than half a century in the field of corporate law. They have advised on some of the notable transactions in the market and internationally. In addition to our local and international experience, the Firm has developed relationships and partnered with renowned international law firms with offices in the world's major financial centres.

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1 Overview

1.1 What are the main trends/significant developments in the lending markets in your jurisdiction?

Despite the economic slowdown the country has faced since 2014, the lending market in Brazil continues to increase at a healthy pace, with a recent diversification of players from a number of fintechs becoming more active in this space. Official interest rates (SELIC, created in 1996) are currently at their lowest level in the history of this index, and lending activity is expected to pick up pace as the Brazilian economy starts to recover from the recession.

1.2 What are some significant lending transactions that have taken place in your jurisdiction in recent years?

In January 2019, Suzano Papel e Celulose SA closed a deal to purchase Fibria Celulose SA and raised more than US$9 billion in cash. The transaction involved the participation of several financial institutions including Itau BBA, J.P. Morgan, Bradesco and others.

In April 2019, Engie and CDPQ raised a US$2.4 billion cross-border loan from a syndicate of banks and R$14 billion (US$3.7 billion) in bonds (debentures) in Brazil for the purchase of TAG, which is Brazil's largest gas pipeline company, operated by Petrobras. The financing was obtained without the need for shareholders' guarantees and the transaction was backed only by the assets acquired by TAG.

It is worth noting that the issuance of bonds is becoming increasingly popular in Brazil as a financing mechanism, especially so-called "incentivised debentures", which may benefit from tax incentives. The issuance of such bonds amounted to R$33.8 billion in 2019, which represents an increase of 56% as compared to 2018.

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, companies may guarantee borrowings of one or more other members of their corporate group. However, when the company is granting upstream guarantees (a subsidiary guaranteeing the debt of a parent company) and the company has minority shareholders, there may be concerns regarding potential claims of shareholder abuse.

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 specific financial assistance laws in Brazil, but shareholders and management are required to act in the best interest of the company and could be subject to liability in the context of rules regarding shareholder abuse. However, in principle there should be no enforceability concerns if the relevant transactions were properly authorised pursuant to company bylaws.

2.3 Is lack of corporate power an issue?

Yes. The signatory of the guarantee must have the appropriate corporate powers as per the bylaws/articles of associations of the guaranteeing/securing company. However, there are some court decisions recognising the validity/enforceability of guarantees granted without the formalities of corporate power (without observing the procedural rules set forth in the bylaws), but where the company seemed to be properly represented (for example, where documents were signed by company executives) and the beneficiary acted in good faith.

2.4 Are any governmental or other consents or filings, or other formalities (such as shareholder approval), required?

All requirements contained in the company's bylaws for the granting of guarantees/security must be complied with. The bylaws would determine whether any approvals by the company's board of directors or shareholders are required.

2.5 Are net worth, solvency or similar limitations imposed on the amount of a guarantee?

There are no legal limitations on the amount of the guarantee that may be granted, but the relevant counterparty may take these aspects into consideration.

2.6 Are there any exchange control or similar obstacles to enforcement of a guarantee?

Payments under guarantees in favour of foreign counterparties may be made directly at a commercial bank authorised to carry out foreign exchange transactions upon presentation of the relevant documentation.

3 Collateral Security

3.1 What types of collateral are available to secure lending obligations?

Collateral provided for under Brazilian law may be divided into three main classes: (i) personal guarantees (*garantias pessoais*), which entail the creation of a personal commitment for the performance of a given obligation; (ii) real guarantees (*garantias reais*), covering obligations that are secured by one or more specific assets, which property rights remain with the debtor; and (iii) fiduciary real guarantees (*garantias reais fiduciárias*), which generally involve the transfer of the title over the secured asset to the creditor, which restitution shall be subject to the satisfaction of the secured obligation. Each of the classes of guarantees generally described above are subject to some particularities provided for under Brazilian law. Please see question 3.3 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?

All-asset security structures present in other countries are not available under Brazilian law, and each individual asset over which security is created must be properly identified.

The security agreement will depend on the type of asset to be secured. Depending on the type of security, different perfection requirements and other peculiarities must be observed, such as registration with various public registries depending on the type of asset, notices to counterparties, etc.

3.3 Can collateral security be taken over real property (land), plant, machinery and equipment? Briefly, what is the procedure?

Yes. The most common types of real guarantees are mortgages, pledges and fiduciary assignments of title to real property.

Mortgages are generally created over immovable properties, although some movable properties may be secured by mortgages, such as aircraft and vessels, which are also regarded as special mortgages (*hipoteca especial*) and governed by specific federal laws. The title and possession over the assets remain with the borrower. Mortgages are created through the registration of the security with the competent public registry of the place where the asset is located and second and third mortgages may be created over a given asset.

As a general rule, pledges may be created over movable assets. The custody of the pledged assets should be transferred to the lender as a default, but more often than not the debtor is allowed to keep possession of the pledged assets. Pledges are created through the registration of the security with the competent public registry of the place where the asset is located.

The main difference between a security created under a fiduciary assignment (*alienação/cessão fiduciária*) in relation to the security created by mortgage or pledge is that, in the fiduciary assignment, the debtor effectively transfers its property rights over a given asset to the creditor. The creditor then becomes vested with a special sort of "reversible ownership", under which restitution to debtor is conditioned on the satisfaction of the secured obligation. Possession rights over the secured asset, however, remain with the debtor.

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. For an assignment of receivables to be perfected, the debtors must be notified of the assignment. Another alternative would be to create security over the account into which receivables are paid, but that would not constitute a true assignment of receivables and would not give the creditor the right to enforce payment directly from the debtors.

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 very usual and can be formalised under Brazilian law by pledge or fiduciary assignment structures. In order for the bank to agree to control the account and block unauthorised transfers, it is common for an account management agreement to be entered into with the relevant bank where the cash is deposited in order to control access to the relevant 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 is frequently taken over shares or quotas of the relevant company by means of pledge or fiduciary assignment structures. For purposes of perfection, the security must be formalised in written form, contain references to the secured amount, describe the shares/quotas granted as security and be registered with the relevant Registry of Titles and Deeds of the debtors' corporate seat, as a condition of effectiveness for pledges and validity of the fiduciary property. In addition, in order to be enforceable against third parties, the pledge must be registered, as the case may be, in the shares registry book of the relevant company (if it is a *Sociedade Anônima*).

The granting of such collateral of shares/quotas of a company incorporated under Brazilian law (and located in Brazil) is typically governed by Brazilian law.

3.7 Can security be taken over inventory? Briefly, what is the procedure?

Yes, but revolving pledges are not generally available. Revolving pledge structures may be implemented in certain specific cases, or else the parties may agree to amend the list of assets covered by the security from time to time.

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, as long as the rules of the bylaws/articles of associations of the guaranteeing/securing company are observed.

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?

According to Brazilian law, security instruments must be registered with applicable public registries in Brazil, and the specific registry will vary depending on the type and location of the security (for example, the real estate registry of the relevant municipality in case of a mortgage, the registry of deeds and documents of the debtor's headquarters in the case of a pledge on receivables, etc.). Documents signed abroad must be notarised by a notary public at the place of execution, legalised with the nearest Brazilian Consulate (or apostilled if the country where the document is signed is a member of the Hague Convention), and translated into Portuguese by an official translator before they can be registered with the relevant public registry in Brazil. Public registry fees are determined by local regulation and will also vary depending on the type of security and value of the secured obligation.

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?

Depending on the location of the registration, type of security and amount of the secured obligation, the public registry fees may be significant. Public registries located in larger cities tend to have faster processing times than those located in remote areas.

3.11 Are any regulatory or similar consents required with respect to the creation of security?

Transactions involving public entities or relating to projects that involve public concessions or are otherwise subject to regulation (such as power, oil & gas, public infrastructure concessions, etc.) are subject to the applicable rules of the relevant regulations, and which may impose restrictions regarding the project's ability to give security over assets that are deemed essential to the company's operations and may limit the lenders' ability to enforce certain of the debtor's obligations.

3.12 If the borrowings to be secured are under a revolving credit facility, are there any special priority or other concerns?

Brazilian law requires the amount of the secured obligation to be stated in the security documents. In case of a revolving credit facility, this will usually be the maximum amount available under the credit facility.

3.13 Are there particular documentary or execution requirements (notarisation, execution under power of attorney, counterparts, deeds)?

In addition to the requirements mentioned in questions 2.3 and 3.9 above, it is worth noting that: (i) documents formalising the collateral security must be in written form, executed by all parties and attested by two witnesses; (ii) security agreements involving certain assets, such as real property and vessels, must be in a public form (recorded by a public official); and (iii) as Brazilian law does not contemplate the concept of "counterparts", in case the intention is to enforce the agreement directly in Brazil, an original copy of the relevant agreement should be signed in "ink" by all parties, so that it may be presented before Brazilian courts if necessary.

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 are no specific financial assistance rules prohibiting these transactions. However, the bylaws of the company may contain restrictions regarding the granting of collateral to secure third party obligations, and general rules regarding shareholder abuse may also come into play in cases where the majority shareholder approves transactions that are not in the interest of 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?

There is no legal concept of a "trust" in Brazil. A mandate structure must be adopted to accommodate the syndicate 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?

It is common for the agent to sign documentation on behalf of and for the benefit of the lenders, but since Brazilian law does not recognise the syndicate agent as a trustee, in the event of insolvency or enforcement it is common for all syndicate members to participate directly in the insolvency proceedings or enforcement procedures.

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?

Under Brazilian law, the mentioned credit assignment can be considered as valid as long as the relevant debtor is notified of the credit assignment by Lender A to Lender B.

With respect to the guarantee, in these cases it is advisable to obtain a guarantee confirmation from 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?

Interest payments made by Brazilian companies to other Brazilian companies are subject to the same tax treatment applicable to fixed income investments – the interest payments are subject to Withholding Income Tax and the applicable rates vary from 22.5% to 15% based on the term of the loan.

Interest payments made by Brazilian companies to foreign lenders are, as a rule, subject to Withholding Income Tax at a 15% rate – exceptions are made for lenders located in low-tax jurisdictions or under privileged tax regimes, in which case the applicable rate is 25%. Lower tax rates may be applicable if Brazil has signed a double tax treaty with the country in which the lender is domiciled. Nevertheless, it is common that gross-up mechanisms are established in these cases, so that the payments abroad are made net of taxes.

In any case, transfer pricing and thin capitalisation rules may be applicable to foreign loan transactions.

Payments arising out of the enforcement of guarantees or security are generally subject to the same rules applicable to the original guaranteed amounts. In other words, the treatment is the same as if borrower made the payments.

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?

Brazilian tax law provides for several tax incentives to non-resident investors, which may vary depending on the project, the borrower or even the financing structure. In some cases, the incentives are focused on foreign investors – as an example, payments connected to debentures issued by Brazilian Special Purpose Companies for the development of infrastructure projects, if some requirements are met, are not subject to Withholding Income Tax if the beneficiary is a foreign investor, but are subject to a 15% rate if the investor is a Brazilian legal entity.

Non-resident investors also benefit from several tax benefits when investing in the local capital markets.

In addition, there are local tax incentives offered by States and Municipalities (generally connected to Value Added Tax or Tax on Services), which aim at enhancing investment in local production and exports by means of tax exemptions, taxable basis and rate reductions, etc.

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?

Considering that Brazilian rules on international taxation do not provide for the taxation of lending transactions, no taxation would be imposed on the income of a foreign lender solely because of a loan to, or a guarantee and/or grant of security from, a company in Brazil.

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.?

A loan entered into between a foreign lender and a Brazilian borrower would be subject to the collection of withholding income tax on the portion related to interest deriving from the loan transaction (assuming no gross-up mechanism would apply). Upon the inflow of the funds related to the loan, the transaction would be registered with the Central Bank of Brazil on its electronic system (RDE-ROF). Currently, the foreign exchange ("FX") transactions carried out in connection with cross-border loans with a minimum average term of 180 (or more) days benefit from the IOF/Exchange with a zero rate. Cross-border loans with an average term shorter than 180 days are subject to a 6% IOF/Exchange rate.

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.

Cross-border loans involving a Brazilian borrower may subject the Brazilian party to the application of Brazilian thin capitalisation and transfer pricing rules, which could limit the portion of interest paid considered deductible for Corporate Income Taxes purposes. As for Brazilian thin capitalization rules, despite the fact that there is no limit on the parties' ability to agree on a given interest rate, interest expenses are only deductible by a Brazilian borrower if (i) it is necessary for the activities conducted by the Brazilian debtor, (ii) the amount of the debt owed to a foreign-related party does not exceed twice the amount of the equity interest held (maximum 2:1 debt/equity ratio), and (iii) the aggregate debt held by all the foreign-related party lenders does not exceed twice the amount of the aggregate equity held by all foreign-related party lenders in the Brazilian borrower. Also, for creditors located in tax havens or privileged tax regimes, the limits indicated in item (ii) above are stricter, so that instead of a maximum 2:1 debt/equity ratio, the maximum indebtedness ratio would be 0.3:1 (30% of the equity held or net worth of Brazilian borrower). In relation to transfer pricing rules, interest paid to foreign-related parties is not deductible to the extent they exceed the following rate parameters, even if BACEN has granted registration for the loan above such rate: (i) for U.S. dollar-denominated fixed (predetermined) rate transactions, the parameter is the market rate applicable to sovereign bonds issued in U.S. dollars by the Federative Republic of Brazil in the external market; (ii) for Brazilian Real-denominated fixed (predetermined) rate transactions, the parameter is the market rate applicable to sovereign bonds issued in Brazilian Reais by the Federative Republic of Brazil in the external market; and (iii) in other cases, the parameter is the six-month LIBOR applicable to the specific currency of the transaction or, if no LIBOR rate is published for such currency, the LIBOR for six-month U.S. dollar deposits. In addition, any of the parameter rates above may be increased by a spread determined by the Ministry of Finance in accordance with the average spread prevailing in the market (currently, 3.5% for deductibility of interest paid to lenders abroad).

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 a foreign governing law constitutes a valid choice of law and does not contravene Brazilian law. Submission by the parties to another jurisdiction is valid and binding under the laws of Brazil. Brazilian courts would enforce a contract that has a foreign governing law that is subject to the jurisdiction of Brazilian courts. In this case, proof of the foreign law should be presented, but in practice, there is a high risk that Brazilian courts would interpret the agreement using concepts of Brazilian 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 be recognised and enforceable against a Brazilian company by the courts of Brazil without a re-examination of the merits of the case if it was previously confirmed (*homologado*) by the Superior Court of Justice (Superior Tribunal de Justiça – STJ), which confirmation may only occur if such judgment: (a) fulfils all formalities required for its enforceability under the laws of the country wherein it was issued; (b) was issued by a competent court after due service of process on the parties; (c) is not subject to appeal; (d) was authenticated by a Brazilian consulate in the country wherein it was issued or apostilled by the designated authority, as applicable, and is accompanied by a sworn translation into Portuguese; (e) is for payment of a certain sum; and (f) is not contrary to Brazilian public policy, sovereignty, human dignity or good morals.

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?

Generally, it is hard to accurately estimate the duration of lawsuits in Brazil due to the lack of uniformity between each state's jurisdiction in this regard. However, it is likely that, in the case of (a) above, it would take approximately two to three years and, in the case of (b) above, it would take approximately 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?

The creditor's right to keep the assets given as a collateral security in case of foreclosure is subject to certain legal restrictions. Originally, enforcement procedures under Brazilian law used to require a public auction for sale of the asset given as security. Nowadays, private sales may be allowed depending on the asset, but the principle remains that the creditor should transfer the asset to a third party to recover the debt, and any excess must be returned to the debtor.

In respect of security granted by public concession holders, regulatory consent may be required for enforcement, such as the transfer of shares, for example, to another company.

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 Brazil, Brazilian law provides that non-residents with no real estate property in Brazil will be required to provide a bond as collateral in order to guarantee the payment of statutory attorneys' fees and court expenses. The bond is not required in certain cases, such as for the enforcement of collateral security agreements deemed as directly enforceable documents (*título executivo extrajudicial*).

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 liquidation

Law n. 11,101/2005 (the "Bankruptcy Law") provides for a stay period triggered by declaring the bankruptcy liquidation of the debtor. Accordingly, all foreclosure and enforcement proceedings against the debtor should be stayed. All the debtor's assets (even the assets given as collateral) will be gathered, scheduled, appraised and liquidated by the trustee. The proceeds will then be used to pay creditors, pursuant to a certain ranking of priority (waterfall). In that sense, the creditor holding the collateral would not necessarily be paid with the proceeds arising from the enforcement of the collateral security if the debtor does not have enough assets to cover higher ranking claims.

Judicial reorganisation

Besides that, the Bankruptcy Law provides for an automatic stay, which is triggered by a court order allowing the judicial reorganisation to be processed. During the stay period, all legal actions and enforcement proceedings against the debtor are stayed with regard to creditors subject to/affected by the judicial reorganisation proceedings. The stay in judicial reorganisation proceedings should not exceed 180 days.

Extra-judicial reorganisation

The Bankruptcy Law establishes that the filing of an extrajudicial reorganisation proceeding should not stay rights, actions, enforcements or involuntary bankruptcy liquidation filings with respect to creditors that are not subject to/affected by the plan of extrajudicial liquidation.

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. For foreign arbitral awards, however, the same procedure as described in question 7.2 will apply.

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 enforcement proceedings that could pose a judicial lien over the debtor's assets are stayed for 180 days following the court decision which accepted the bankruptcy proceeding, except if: (i) the reorganisation plan (*plano de recuperação judicial*) is not approved within the stay period; and (ii) unless it is not extended for an additional period at the court's discretion, the creditors should be able to resume the execution and enforcement proceeding. Courts tend to extend the stay period whenever necessary.

It is worth noting that, in the context of security packages involving fiduciary assignments, technically speaking the assets leave the debtor's estate and become the property of the creditor. As a result, in case of bankruptcy of the debtor, such assets should not be subject to the bankruptcy and the creditor may recover the asset without having to join the bankruptcy judicial proceeding, but there are certain exceptions to this rule, namely in case the assets are deemed essential to the company's business activities.

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 clawback period is established by the relevant bankruptcy court beginning as of 90 days before: (i) the date of the first protest for non-payment by a public notary; (ii) the date of the filing for voluntary or involuntary bankruptcy; or (iii) the date of the filing for judicial reorganisation proceedings (as applicable). Preferential transfers do not necessarily involve wrongful actions (i.e. with the purpose of emptying the company's estate) and may be deemed as preferential or unfair regardless of the intention of the parties. The proceeds of the judicial sale of the bankruptcy estate's assets must be paid to the creditors according to the following order of preference: (a) motions for restitution (provided for the return of third party property to the respective owner; (b) administrative claims (in Portuguese, *créditos extraconcursais*, which include claims constituted after adjudication of the bankruptcy); and (c) pre-petition claims (in Portuguese, *créditos concursais*), sub-divided into (i) labour claims (capped at 150 minimum wages per employee), and credits originating from occupational accidents, (ii) secured claims up to the limit of the value of the encumbered asset, (iii) tax claims (tax fines excluded), (iv) special privilege claims set out by law, (v) general privilege claims set out by law, (vi) unsecured claims, (vii) contractual fines, pecuniary penalties and tax fines, and (viii) subordinated credits/claims.

8.3 Are there any entities that are excluded from bankruptcy proceedings and, if so, what is the applicable legislation?

Yes. Different legislation governs the insolvency of financial institutions, utilities, insurance companies and other entities. The Bankruptcy Law does not apply to state-owned corporations (*empresas públicas*) or companies with private capital but controlled by governmental bodies (*sociedades de economia mista*).

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 enforcement is the prevailing rule for security over shares and it is generally authorised under the contract and performed, in case of pledges, through an irrevocable power-of-attorney executed by the guarantor, granting to the relevant lender the necessary powers to conduct the out-of-court sale. The granting of powers-of-attorney on behalf of the lenders as part of the security package, providing the lenders with the power to replace the company's management in case of a default, is an alternative structure aiming to achieve the same objectives as traditional step-in rights. However, self-repossession of assets granted as security like we see in jurisdictions such as the U.S. is usually not allowed.

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, submission to a foreign jurisdiction is generally legally binding and enforceable, subject to limited exceptions.

9.2 Is a party's waiver of sovereign immunity legally binding and enforceable under the laws of your jurisdiction?

Sovereign immunity in Brazil only applies to governmental bodies and public entities. Foreign governmental bodies usually have absolute sovereign immunity in Brazil, and only an express waiver of immunity would be enforceable against them in Brazil. Brazilian public entities have limitations as to the circumstances in which they may waive sovereign immunity, and when they do waive immunity, the waiver will often be limited to a waiver of immunity from suit, not a waiver of immunity from enforcement. If a waiver has not been expressly granted and properly authorised, it is likely that Brazilian courts would not treat the waiver of sovereign immunity as 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?

Lending to a given company in Brazil can be done by individuals or other companies (not necessarily a financial institution under the supervision of the Central Bank of Brazil), but individuals and non-bank companies would be subject to restrictions such as certain limitations on interest rates.

Foreign entities need a special authorisation from the Central Bank of Brazil to either open branches in Brazil or hold an interest in Brazilian financial institutions.

Financial institutions are, generally speaking, the only agents authorised to hold deposits and issue credit to the public. The performance of activities exclusively reserved for financial institutions is considered a criminal offence.

Finally, there are no specific eligibility requirements in Brazil for a financial institution to act as an agent under a syndicated facility for lenders to a 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?

Adequate and prompt legal counsel is advisable when participating in financings in Brazil. Depending on the financing transaction and parties involved, different risks should be taken into account (i.e. political and regulatory risk, especially for financings to companies that rely on agreements with the Public Administration for revenues). In addition, care must be taken to ensure the enforceability of security packages under Brazilian law, with due regard for perfection requirements and other peculiarities of a civil law jurisdiction, which is significantly more formalistic than common law jurisdictions tend to be.

Lior Pinsky is a partner who represents a wide range of corporate clients in their most pressing legal needs. He has been recognised as a leading Brazilian lawyer in areas such as M&A, banking & finance and capital markets by publications such as *Chambers Global*, *IFLR*, *Latin Lawyer* and *LACCA*. Lior has a Bachelor's degree in law (LL.B.) from the Pontifical Catholic University of São Paulo Law School (1997) and a Master of Laws degree (LL.M.) from the London School of Economics and Political Science. In addition, Lior practised in the corporate department of Cravath, Swaine & Moore LLP, in New York, from October 2004 to May 2006. Lior has taught at the postgraduate school of Insper in São Paulo for more than eight years.

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VEIRANO ADVOGADOS

British Virgin Islands

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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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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 continues to remain 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.

Although it is anticipated that LIBOR will be discontinued after 2021, the future of the Canadian Dollar Offered Rate (CDOR) – the corresponding reference rate to LIBOR used for Canadian Dollar loans – is less clear. There are currently no definitive plans to discontinue the use of CDOR; however, the Bank of Canada and the Canadian Alternative Reference Rate Working Group (CARR) have selected the Canadian Overnight Repo Rate (CORRA) as the alternative risk-free rate for CDOR. Unlike many other proposed risk free rates, CORRA has been in place since 1997 and has been used as a reference rate in connection with overnight index swaps. CARR has recommended certain enhancements to CORRA which are anticipated to go into effect in 2020. Nevertheless, it is also expected CDOR will continue to be used alongside Enhanced CORRA for the time being. It remains to be seen whether the Canadian market has the liquidity to support both rates in the long term or whether the use of other risk-free rates in other jurisdictions will encourage the adoption of Enhanced CORRA instead of CDOR. In the meantime, there has been increasing usage of fallback language for CDOR in loan documentation to address the potential demise of CDOR.

1.2 What are some significant lending transactions that have taken place in your jurisdiction in recent years?

Domestic and cross-border lending in Canada has remained active in recent years. Significant matters include financings for Frontera Energy Corporation, Tricon Capital Group, leveraged acquisition financings such as the acquisition of Trader Group, Canada's largest digital automotive marketplace and software solutions provider, and Aucerna, a supplier of software to the oil and gas industry. Significant recent asset-based lending transactions include the financings of Algoma Steel and Resolute Forest Products.

Lending in the public-private partnership (P3) space has continued its momentum, as more provinces and municipalities are turning to the P3 model for funding their infrastructure projects. For instance, 2019 saw the Province of Ontario move one of the largest infrastructure projects in the province forwards with the awarding of a P3 contract valued at $4.6 billion for the Hurontario LRT.

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 and British Columbia, 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 and amendments to British Columbia's PPSA that came into force on June 1, 2019, 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, under the *Civil Code of Québec*, it is 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 Canadian PPSA jurisdictions (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 recourses 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, such as participating debt interest, 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 are subject to withholding tax.

The thin capitalisation rules may also 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 further 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 an entity incorporated or formed by or under the laws of a country other than Canada 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) engages in the business of providing 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) engages in the business of providing financial services and is affiliated with a foreign bank, or (v) a foreign institution (that is not captured by the criteria in (i) to (iv) above) that controls a foreign bank or a Canadian bank. A "foreign institution" means an entity not incorporated in Canada that is engaged in the business of banking, the trust, loan or insurance business, the business of a cooperative credit society or the business of dealing in securities or is otherwise engaged primarily in the business of providing financial services.

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. There is uncertainty about the exact boundaries of the general prohibition against engaging in or carrying on business in Canada. The Act itself does not provide specific guidance on the factors that the main bank regulator – i.e. Office of the Superintendent of Financial Institutions (OSFI) – may take into account in determining whether a foreign bank is engaging in or carrying on business in Canada. OSFI will generally assess the particulars of each case against factors comparable to those considered by judicial bodies in interpreting the concept of "carrying on business in Canada" under statutes such as the *Income Tax Act*, keeping in mind that the policy considerations under other statutes may not be the same as under the *Bank Act*.

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 4, 2019. 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

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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. The robust and creditor-friendly legislation in the Cayman Islands provides counterparties with significant comfort in secured lending transactions and, as a result, we continue to see an increase in the use of hybrid and NAV facilities in both the private equity and hedge fund space and the continued reliance on 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 also see an increasing use of limited liability companies as a result of advantageous hybrid features taken from both the company and exempted limited partnership regimes. The global regulatory shift has enforced the position that the Cayman Islands is a leading and well-respected and relied upon jurisdiction for many lending houses and financial institutions in 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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1 Overview

1.1 What are the main trends/significant developments in the lending markets in your jurisdiction?

According to the Chilean Financial Market Commission ("CMF"), the entity which replaced the former Superintendency of Banks and Financial Institutions (as discussed below), during the 12 months leading up to November 2019, there was a significant growth of borrowers in the supervised lending industry (including banks, loans and savings cooperatives and banking supporting companies), increasing from 5,197,815 in November 2018 to 6,523,076 in the same month of 2019. In the same period, credit (i.e. amounts being loaned) grew by 11%, compared to 9.93% in 2018 and 2.54% in 2017.

The above is explained mainly by the substantial decrease of interest rates for housing lending during 2019, which reached historical lows, helping this sector to show a material increase. This resulted not only in an increase in new housing loans, but also in the refinancing of existing loans, which showed a major 40% growth during the 2019 period.

A major reform to the General Banking Act 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 CMF) and new regulations on the resolution process. During late 2019 and the beginning of 2020, the CMF has made available for public consultation several regulations with the purpose of implementing Basel III standards, especially regarding capital requirements and risk management. It is expected those regulations will come into force before the end of this year.

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.
- CÓNDOR ENERGÍA, a Mainstream local subsidiary, on the USD 580 million financing granted by CaixaBank, DNB, KfW IPEX-Bank, Natixis, SMBC and Société Générale, for the construction of three wind farms in the northern and southern regions of Chile, with a combined generation capacity of 571 MW.
- BANK OF CHINA, and other financial institutions, on the USD 450 million senior financing granted to Food Investment, a subsidiary of Joyvio Agriculture, for the acquisition of up to 100% of Australis Seafoods, a major participant in the Chilean salmon industry.

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 CLP 40,000 (approx. USD 50) 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 (or legalised, if it was extended in a country that is not a member of the Apostille Convention), and if not in Spanish, they 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 allow 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, although in this case, such mandate will be subject to general rules, but not to the simplified granting and collateral management provisions applicable to the security agent pursuant to Chilean 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?

Yes. Individual lenders can also issue a mandate for a local entity/person to act on their 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, or that the debtor accepts it. Otherwise, the assignment cannot be enforced against the debtor or third parties.

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 withholding tax rate of less than 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 may individual foreclosures, any kind of executions or restitutions in lease trials 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?

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 crowd-lending 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 begun 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, shareholder 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 a 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, the intention of which is for banks and financing entities to quantify its clients' credit capacity and related risks and force 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 10 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 12 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 the answer to question 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

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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 Croatia has experienced growth in corporate lending over the last few years due to increased liquidity and facilitated conditions, a trend which continued in 2019. 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.

Positive annual growth rates have been ongoing since September 2017, confirming the recovery of lending activity in the retail sector. According to the latest statistics published by the Croatian National Bank in August 2019, retail loans continue to rise, mostly residential in type. Growth in general-purpose cash loans has been recorded as well. The Croatian National Bank reports that total retail loans amounted to HRK 130 billion (approx. €18 billion) by the end of August, which is a 6.3% annual increase in nominal terms. One of the main reasons for such an increase in retail loans is most likely the continuing trend of falling interest rates. Furthermore, these results can probably be linked to some favourable developments in the labour market such as higher employment and wages in an environment of low financing costs and a high level of consumer optimism. It is expected that, by the end of 2019, bank lending activity will continue to rise, led by retail lending. On the other hand, corporate loans recorded an increase of only 0.6% due to the activation of state guarantees granted to shipyards, which are now mostly subject to bankruptcy proceedings.

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. Major infrastructure projects are not financed by private loans but through EU funds, the European Investment Bank, the European Bank for Reconstruction and Development 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 January 2021) was awarded €101.40 million from the EU Connecting Europe Facility fund.

The sale of non-performing loans in Croatia hit a peak a few years ago, but continues to produce good results. In the second quarter of 2019, HRK 407 million (around €55 million) was sold at a purchase price of 55.04%. 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?

Probably the most significant event lending-wise in the last few years with repercussions evident to this day is the case of Agrokor. The group, which is one of the largest retail stock companies in South East Europe, nearly went bankrupt in 2017, after they had acquired several large companies (e.g. the biggest Slovenian retail chain, Mercator, valued at €500 million). 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 together with Agrokor's expansionary moves and cross-collateralisation within the group brought them close to bankruptcy. Consequently, the Croatian 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. The settlement is being implemented in 2019. 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 settlement's implementation started in April 2019 and resulted in the formation of the Fortenova group, a new concern to take over Agrokor's assets, consisting of a total of 159 subsidiary companies employing 52,000 people. The latest development in the restructuring process happened in August 2019 when the Commercial Court of Zagreb issued a decision declaring the termination of extraordinary administration proceedings for 22 affiliated companies of Agrokor Group, which were then transferred to Fortenova. The restructuring of Agrokor is thought to be one of the most successful international restructuring processes 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 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 in an 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 a 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 property 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; they have not been used for many 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 the Croatian Private International Law Act, 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 a 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 asset: (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; according to 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 cases 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 cases 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?

As a principle, Croatian courts 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. However, the Private International Law Act provides for certain exceptions to the rule with the purpose of protecting Croatia's public interests. These fall under two general categories, *ordre public* rules and rules of immediate application. The latter are implemented in accordance 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 (Rome I).

Pursuant to the rule of immediate application (Article 13 of the Private International Law Act), the court may apply a provision of Croatian law the respect for which is regarded as crucial for safeguarding the country's public interests, such as 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.

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 an 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 (Brussels I bis), which provides 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 Private International Law 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 was infringement of the party's right to participate in the proceedings;
- whether there is exclusive jurisdiction of Croatian courts;

- whether there is already an existing judgment (*res judicata*); and
- whether the judgment is contrary to the *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?

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, and the foreign lender plaintiff is not a Croatian national or resident, nor a national or resident of another EU or EEA Member State or a member state of such treaty, it could be requested that the foreign lender plaintiff give 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 Private International Law Act, the parties can choose the forum of a court of a non-EU Member State if there is no exclusive jurisdiction of the Croatian court or a court of an EU Member State. Also, according to Article 25 of Brussels Ibis 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, and the object of the loan is always money and interest always applies; 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 the Bankruptcy Act. Both acts also regulated interest rates. Interest rates depend on the reference rate set by the Croatian National Bank.

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The firm's client base includes domestic and international banks, insurance companies, ship owners and corporations: often major international companies with high-profile and high-value matters.

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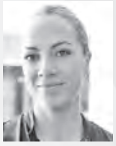
George Economides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1 Overview

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.

Seven 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 third quarter of 2019, was positive and estimated at 3.4% above the corresponding quarter of 2018. Such increase is mainly attributed to sectors such as construction, information technology, communications and more.

Although levels of non-performing loans (NPLs) still remain relatively high, recent Central Bank of Cyprus (CBC) statistics as per the third quarter of 2019 confirm that in the month of September 2019, non-performing facilities fell to €9.6 billion (29.3% of total loans), marking the lowest level of NPLs since the 2013 financial crisis. The acquisition by Hellenic Bank of the performing part of the state-owned Cyprus Cooperative Bank, 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. Furthermore, the acquisition of a number of NPLs from various financial institutions and asset management organisations has significantly decreased such rates as well.

Also, up until the third quarter of 2019, the criteria for granting loans remain unchanged while loan demand slightly decreased. According to the statistics and estimates issued by bank surveys, such decrease is, due to various factors, not expected to continue.

Finally, recently implemented structural measures, which 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 Law 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, 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 to the assignability of the receivables in question); (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 Law 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: (a) the giving of notice of pledge by the pledgee to the company in which the shares are pledged; (b) 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 (c) the subsequent delivery by the company of a certificate confirming (b) 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 Law 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 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 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 of a pledge over shares in a Cyprus company pursuant to the Contract Law 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 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 recognises the role of a security agent or trustee holding 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 inter-creditor 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 – 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 7.6.

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?

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 rest 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); 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 Law 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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E & G Economides LLC, based in Limassol, Cyprus, specialises in Corporate & Commercial, M&A, Banking & Finance and Capital Markets work. Litigation, Immigration, Real Estate, Financial Services, Data Protection, IP and Privacy and Private Client matters are also offered. With a team currently comprising over 18 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.
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1 Overview

1.1 What are the main trends/significant developments in the lending markets in your jurisdiction?

Interest rate levels continue to fall. General market conditions for doing business in Denmark continue to improve. Particularly, the Danish real estate market is attractive to foreign investors. 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 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 restriction 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, intellectual property rights 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 a 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 clawback in case of bankruptcy.

If negotiable share certificates have been issued, perfection requires that the pledgor is deprived of its physical share certificates. However, physical share certificates are in practice never 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 (there is 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 law. 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: *noglepant*).

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 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 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.

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.

The 'thin capitalisation' rule

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.

The 'interest-rate ceiling' rule

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.

Although the 'Brexit' situation is now clarified, legal uncertainty still remains in respect of contractual relations involving parties based in Denmark and the UK concerning choice of law and jurisdiction issues. Consequently, parties affected by this may with good reason circumvent this by entering into a choice-of-law agreement specifying the relevant applicable 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?

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 judgments 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, 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.

As a consequence of the UK now having left the EU, parties affected may in the circumstances agree on arbitration in order to mitigate the legal uncertainty as to recognition and enforcement of a 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?

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 nine to 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 months 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 results 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 if the recipient of a gift cannot prove that the debtor undoubtedly kept sufficient assets to cover its liabilities – up to one 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.

Under the Bankruptcy Act, 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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1 Overview

1.1 What are the main trends/significant developments in the lending markets in your jurisdiction?

After a number of delays and much political debate, the United Kingdom ceased to be a member of the EU at 11pm (UK time) on 31 January 2020. The UK and Europe now have until the end of 2020 to agree the terms of a trading relationship that will apply after Brexit and, although the UK Government has indicated that these discussions must be concluded within the 12-month post-Brexit transition period, the market view is that the likelihood of the UK and EU failing to agree to a relationship and the UK being left to trade on World Trade Organisation terms has reduced. The loan markets remained relatively robust throughout the Brexit negotiations and although momentum in UK lending did slow at various points during the negotiation period, particularly in the lead up to the UK General Election in December 2019, the market has rebounded quickly now that Brexit has occurred and there is more certainty around the direction of travel.

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 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.

Sustainable finance has been a rapidly developing area in the loan markets during 2018/2019. Until recently, the market for sustainable finance was made up primarily of bonds (and, to a lesser extent, term loans) funding "green" projects. Now sustainable lending increasingly provides flexible solutions to borrowers who wish to incorporate environmental, social or governance targets into their funding. The documentation continues to develop as the market evolves, with many loan agreements featuring a mix of (i) incorporating a sustainable project into the purpose clause, (ii) a requirement to hold a minimum level of sustainable assets and (iii) a margin ratchet which reflects the borrower's compliance with defined sustainability criteria.

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 have been working on proposals for new rates and as we move into 2020 we are starting to see the first loan transactions documented to cater for a shift to those new rates. The Sterling Overnight Indexed Average (SONIA) is looking like the most likely successor for Sterling LIBOR, with the Secured Overnight Financing Rate (SOFR) the dollar equivalent, each being an overnight, backward-looking rate in contrast to LIBOR. On 23 September 2019, the Loan Market Association published exposure drafts of a compounded SONIA-based sterling term and revolving facilities agreement and a compounded SOFR-based dollar term and revolving facilities agreement. These were developed in conjunction with a working group consisting of a range of market participants; however, there is currently no consensus around a number of key components impacted by the transition to the risk-free rates. Our expectation is that by the third quarter of 2020 the market will have settled and we will stop seeing new loans documented referencing LIBOR.

1.2 What are some significant lending transactions that have taken place in your jurisdiction in recent years?

2019's flagship public-to-private deal in the European loan market and one of the largest deals ever in the luxury sector was LVMH Moët Hennessy Louis Vuitton SE's EUR15bn loan financing of the public bid for Tiffany & Co. In addition, the financing of the public bid for Parques Reunidos Servicios Centrales, S.A. by EQT was one of the largest public-to-private transactions of the year and we saw a number of other public acquisition financing transactions, including Bovis Homes part funding their acquisition of Galliford Try's Linden Homes and Partnerships & Regeneration divisions with a £600m syndicated facility.

The USD10bn revolving credit facility for Shell was the first syndicated loan that included SOFR terms and a number of other large corporate lending facilities were advanced over the course of 2019, including for Convatec plc, Capita plc, Next plc, Babcock plc and Informa plc and a debut syndicated financing for Ryanair.

In the leveraged market, we are continuing to advise financiers in the European leveraged finance market on a variety of the most high-profile and high-value mandates, including: on the U.S. and European syndicated senior loan financing for Curium Pharma; on a EUR4.4bn bridge facility supporting the takeover bid financing by ams AG for OSRAM Licht AG; on EQT's proposed merger of the Sivantos Group with Widex; on Advent International's bid for Evonik Industries AG; on Groupe Bruxelles Lambert's acquisition of WebHelp – one of the largest French LBOs in recent years; on the financing of SFR FTTH – one of the first in the market combining elements from conventional infrastructure financing with leveraged finance concepts; and on the EUR1.150bn financing of the CME acquisition by PPF Group – a landmark transaction for the CEE media sector.

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 will avoid going into 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 of business 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 ever be subject to a floating charge, as the chargor would need constant access to the account and repeatedly 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, and 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 mortgagee, then the mortgagee is likely to become a "person with significant control" (PSC) under the PSC regime. The mortgagee 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 the 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, one should consider requirements for third-party consents in 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 in certain cases.

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.?

Generally, 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.

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 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?

Generally, yes. 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?

Generally, yes. A foreign judgment from the New York courts 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, or (e) 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.

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 contract is governed by a foreign-governing 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.

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 with the 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 or on grounds of a serious procedural irregularity or may be able to bring an appeal on a question of English law (although 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 outside England 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 existing statutory moratorium (which will arise in an administration and in some CVAs; see question 7.6 above) will restrict a creditor's ability to enforce its security rights including, for example, by appointing a receiver (see question 7.6 above).

However, an administrator cannot be appointed if, during the interim moratorium, a secured creditor appoints an administrative receiver before the appointment of the administrator becomes effective. In this circumstance, the interim moratorium on enforcement of security would terminate and the permanent moratorium would 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.

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".

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 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 generally ranges from six months to two years depending on the nature of the transaction.

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, although there is a proposal to reintroduce HMRC as preferential creditor in respect of certain taxes; however, the precise timing of such reintroduction has not yet been confirmed); (iv) prescribed part fund (paid *pro rata* to unsecured claimants out of floating charge assets ahead of floating charge creditors – currently subject to a cap of £600,000 per company, although there is a proposal to increase this cap to approximately £800,000; however, the timing of such increase is not clear); (v) floating charge claims; (vi) unsecured claims (customers, contractors, suppliers and secured creditors whose security is insufficient; in the context of financial institutions, unsecured claims are divided into ordinary non-preferential debts, secondary non-preferential debts and tertiary non-preferential debt); 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 within the EU 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 or modified insolvency regimes apply to certain regulated entities such as certain credit institutions, insurance companies, utility companies 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 latter 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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1 Overview

1.1 What are the main trends/significant developments in the lending markets in your jurisdiction?

2019 was another very active year for lenders, with ever more pressure on loan terms and pricing. 2020 started very strongly but the coronavirus crisis impacted ongoing repricing transactions, which have been shelved as a result. The full impact of the coronavirus crisis on the world economy and the lending markets in 2020 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 Webhelp by Groupe Bruxelles Lambert or Socotec by Cobepa and CD&R.

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 including 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 parteneriat – 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 types 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 types 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 April 2020): Anguilla; Bahamas; British Virgin Islands; Fiji; Guam; Oman; Samoa; Seychelles; Trinidad and Tobago; U.S. Samoa; U.S Virgin Islands; Vanuatu; 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.

(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;
- overriding mandatory provisions applicable in France irrespective of the law otherwise applicable to the contract; and
- the application of a rule of the foreign governing law may be refused if such application is manifestly incompatible with the public policy (*ordre public*) of the forum.

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*);
- 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; and
- the application of a rule of the foreign governing law may be refused if such application is manifestly incompatible with the public policy (*ordre public*) of the forum.

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 legal proceedings were instituted:

- judgments given in legal proceedings instituted 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 given in legal proceedings instituted 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 given in legal proceedings instituted before 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 judiciaire* (EC Regulation 44/2001 Annex II). 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 judiciaire*) must be provided with a certified translation of these documents.

In case the declaration of enforceability is granted, 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 given in legal proceedings instituted after 10 January 2015 but before 31 December 2020

As per article 67.2.a of the Agreement on the withdrawal of the United Kingdom of Great Britain and Northern Ireland from the European Union and the European Atomic Energy Community approved by Council Decision 2020/135, EC Regulation 1215/2012 shall apply to the recognition and enforcement of judgments given in legal proceedings instituted before the end of the transition period set on 31 December 2020.

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*). 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 judiciaire* 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 514-3 of the French Code of civil procedure, a stay of enforcement can be ordered by the *Premier Président de la Cour d'appel* if there is a serious ground for overruling 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 18 months.

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; and
- 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).

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?

As reported in the Bank Lending Survey (BLS), which was conducted in September 2019 and published in October 2019, German banks tightened their credit standards for loans to enterprises for the third consecutive period, while, at the same time, they did not tighten their overall terms and conditions (i.e. the actual terms and conditions agreed in the loan contracts). The tightening of credit standards reportedly resulted in an increase of the share of rejected loans, due to the industry or firm-specific situation.

It was also noted that the demand for loans to enterprises with longer interest rate fixation periods rose once again. At the same time, the demand for loans for house purchases was far greater than the financial institutions had expected, due to the low general interest level.

All in all, bank lending to the private sector continued to expand strongly, while loans to the public sector declined again due to the public sector's low financing needs. In the private sector, despite the fact that economic activity in Germany slowed down, domestic enterprises continued to show stronger preferences for long-term loans, which frequently are used to finance longer-term and higher-volume investment plans. Nevertheless, the demand for shorter-term loans also expanded.

Another significant development in the German lending market is the continuous boom of *Schuldschein* borrowing, where *Schuldscheins* with volumes exceeding EUR 1 bn were successfully placed in the market. In this context, digital platforms play an increasingly important role. The important role of *Schuldscheins* was also acknowledged by the Loan Market Association (LMA), which published templates for German law *Schuldscheins* on 31 October 2018 (revised on 21 December 2018).

It should also be noted that sustainable finance is gaining an increasingly important role for the finance sector in Germany. This is reflected, *inter alia*, by the increasing share of Green Bonds, which attract particularly funds invested by investment funds, pension funds and governments. The increasing demand for Green Bonds grants the issuers of Green Bonds access to even lower interest rates. As standards for sustainability are not yet clearly defined, a Technical Expert Group (TEG) is presently working on the development of an EU Green Bond Standard (EU GBS). Furthermore, the Hub for Sustainable Finance Germany (H4SF) and the Green and Sustainable Finance Cluster Germany (GSFCG) are working on clear indicators to set corresponding standards for green finance.

1.2 What are some significant lending transactions that have taken place in your jurisdiction in recent years?

In 2019, significant lending transactions in connection with acquisition financing included RWE increasing its syndicated credit line to EUR 5 bn in preparation for the acquisition of the renewable activities of E.ON and Innogy.

Large-scale real estate-related financing included financing in excess of EUR 1 bn with different structures taken out in connection with the construction of "FOUR Frankfurt".

Noteworthy group financing included E.ON agreeing on a EUR 3.5 bn syndicated revolving credit facility with 21 banks, Berlinovo's syndicated credit facility of EUR 1.15 bn with Berlin Hyp, Berliner Sparkasse and IBB, a syndicated revolving credit facility of EUR 600 m by Südzucker AG as well as a credit facility of EUR 375 m secured by Tom Tailor.

With regard to project financing, significant deals included the acquisition of 56 new Siemens trains with a total volume of over EUR 389 m under a leasing structure by Go-Ahead Bayern, Fahma, a subsidiary of Rhein-Main-Verkehrsbund, securing financing with Helaba for a EUR 500 m acquisition of hydrogen fuel cell-powered trains under a debenture.

Significant export finance transactions included, *inter alia*, a financing package of *ca.* EUR 2.6 bn arranged by KfW IPEX-Bank for the financing of two cruise ships for Dream Cruises being built by the three yards of MV Werften.

Noteworthy is also the arrangement by Deutsche Bank of a EUR 1 bn credit line to finance private investment projects in Angola. This credit line was arranged by the Deutsche Bank team in Madrid at the request of the Government of Angola and guaranteed by its Ministry of Finance.

Finally, large bond placements included Porsche AG's EUR 1 bn green bond for refinancing sustainable projects as well as a EUR 2.1 bn bond issued by IHO Holding alongside a refinancing of existing credit lines of *ca.* EUR 1 bn.

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 legislation, 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 as to 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 entitle 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 a 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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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.

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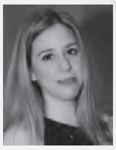

Sardelas Petsa Law Firm

Vasiliki Liappi

1 Overview

1.1 What are the main trends/significant developments in the lending markets in your jurisdiction?

Over recent years, Greece's real estate market has emerged. Companies seek financing in order to finance the acquisition and the development of real estate assets (real estate project finance). Furthermore, the development of real estate is mainly focused on hospitality development projects, which include residences, condominiums, villas and/or apartments.

1.2 What are some significant lending transactions that have taken place in your jurisdiction in recent years?

First of all, institutional lenders, such as the European Bank for Reconstruction and Development ("EBRD") and the European Investment Bank ("EIB") are investing in Greek lending projects, supporting the Greek economy. Secondly, the real estate sector is developing at a fast pace and Greek banks are investing in real estate projects being developed by real estate investment companies ("REIC").

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 Company Law rules for transactions with related parties provide that any contract between a company and its related parties, including guarantees and security of any kind, is prohibited and considered void. No security or guarantee may be granted to any third party or for the benefit of said related parties without the prior permission provided either by the company's Board of Directors or the General Assembly and a relevant announcement in the company's register. However, there are also exceptions under certain circumstances and following specific procedures (i.e. exemption for parent companies guaranteeing borrowings of their 100% subsidiaries). Certain exemptions also apply for listed companies in regulated markets (i.e. in case of a listed company, an auditor's fairness opinion is also required). Finally, entering into transactions in the company's ordinary course of business and on market terms is also excluded.

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, a corporate guarantee shall serve the guarantor's corporate scope. In case such condition is not met, the guarantee may be considered void and directors' liability may arise.

2.3 Is lack of corporate power an issue?

Lack of corporate power may arise only when the guarantor's corporate scope has not been served.

2.4 Are any governmental or other consents or filings, or other formalities (such as shareholder approval), required?

The Company's Board of Directors decides and authorises the provision of a corporate guarantee or security to an affiliate, and such decision is registered in the General Commercial Registry ("GEMH"). The validity of said guarantee and/or security is confirmed after expiry of a 10-day period. Within said period, shareholders holding at least 1/20 of the total share capital of the company may request convocation of the company's General Assembly, in order for the latter to decide on the matter and approve the granting of the guarantee and/or security. Said 10-day period does not apply in cases where all shareholders of the company provide their written consent on granting the said guaranty and/or security.

2.5 Are net worth, solvency or similar limitations imposed on the amount of a guarantee?

There are no such limitations imposed on the amount of a guarantee.

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?

Lending obligations are usually secured by all kinds of collateral, such as security *in personam* (personal/corporate guarantee) and/or *in rem* (mortgage, prenotation of mortgage, any kind of pledge over assets, securities, rights and claims). More specific legislation provides special privileges to credit institutions, such as the legislative decree of 17 July 1923 (which provides in general that any pledge over claims is also considered a legal assignment of said claims to the bank), Law no. 4112/1929 on mortgages over real estate, also including its specific movable assets and machinery, and Law no. 3301/2004 on financial collateral, etc.

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. However, since each type of security has different perfection requirements, a separate agreement is commonly used. Please see below on the creation and perfection of each type of security.

3.3 Can collateral security be taken over real property (land), plant, machinery and equipment? Briefly, what is the procedure?

Mortgage or prenotation of mortgage is the common type of security over land assets, and is being created by a notarial deed (mortgage) or a judicial decision (mortgage prenotation) and perfected by filing said deed or decision with the competent land registry/cadastre of the property. A mortgage provides immediate enforcement action, in case of default. A mortgage prenotation provides a pre-emptive right to its beneficiary for the creation of a mortgage with class as of the date of its initial registration, but being effected after issuing a final decision against the debtor. Said securities also extend to all component parts and accessories of the secured property (i.e. equipment/machinery).

A pledge, without real possession of the asset, and subject to registration in the competent registry, is also commonly used in relation to machinery and/or equipment (Law no. 2844/2000). Such pledge is perfected by registration in the competent register of the place of incorporation of the debtor.

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 on receivables (such as trade receivables, claims, securities, lease proceeds, insurance proceeds, etc.) is usually created by a pledge agreement and perfected by its notification to the third-party debtor of the relevant claims. Common bank practice also includes creation of a pledge and assignment receivables, by virtue of legislative decree of 17 July 1923. Security over commercial receivables is also created pursuant to Law no. 2844/2000 and perfected by registration of an announcement in the competent public registry or the debtors corporate seat, without notification to the third party. Security may also extend to future receivables/claims, to the extent this can be specified.

3.5 Can collateral security be taken over cash deposited in bank accounts? Briefly, what is the procedure?

Collateral security over cash deposits in bank accounts is created by a pledge agreement and perfected by its notification to the bank where such accounts are kept. Common bank practice also includes said security to be created and governed by 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?

Collateral security (pledge) over Greek company shares is created by a pledge agreement and perfected by notification of said agreement to the share company, and endorsement and delivery of pledged shares to the pledgee or a third-party custodian.

Greek companies may issue only registered shares. Bearer shares are no longer acceptable.

Security over shares listed on the Athens Stock Exchange is created by a pledge agreement and perfected by notification and registration to the Dematerialised Securities System, pursuant to the provisions applicable regulations of the stock exchange.

Security may extend to all new shares, dividends, voting rights and/or other benefits. Security agreements may also include contractual limitations on exercising of any pre-emptive rights.

Only Greek law may apply on creation of security over Greek shares.

3.7 Can security be taken over inventory? Briefly, what is the procedure?

Security can be created over inventory, i.e. a group of receivables and/or floating charge. Such security is created by a pledge (floating charge) agreement and perfected by registration in the competent registry of the debtor's 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 provide collateral to secure its obligations both as a borrower under a credit facility and a guarantor of third-party obligations. Please refer to our answer above under question 2.1 in relation to intragroup guarantees/securities.

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 of mortgage, mortgage prenotation, non-possessory pledge and floating charge amounts to approx. 0.775% of the secured amount. Cadastre fees are approx. 0.875% of the secured amount.

Notarial fees range from 0.2% to 1% of the secured amount.

Court fees, in case of prenotation of mortgages, do not exceed €450 for the presence of two lawyers (one for each party).

The legal framework for bond loans provides certain tax and other privileges, such as the limitation of registration fees to €100 and notarial fees to €2,500.

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?

Usually the filing, notification and registration process can be very short. However, special conditions related to the efficiency of the competent authority/land registry/cadastre may impose additional time. On expenses please refer to the previous question.

3.11 Are any regulatory or similar consents required with respect to the creation of security?

In principle, 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. The same procedure applies.

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 the finance and securities documentation.

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 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?

Except to the bondholders' agent, an alternative mechanism may include an intercreditors' agreement between lenders which may provide contractual rights and obligations in relation to securities and payment of the loan proceeds.

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 are permitted in principle, subject to any specific provisions of the relevant loan agreements. Notification requirements to the debtor and/or guarantor are usually necessary.

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 international 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 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 lender to companies under Greek law are credit institutions, regulated by Law no. 4261/2014, and are authorised and supervised by the Bank of Greece. Venture capital companies are regulated pursuant to Law no. 2367/1995, which provides for, as part of its scope, the investment in bonds issued by Greek companies, as well as other licensed companies (i.e. investment firms), which in certain exceptional cases and limited purposes are legally permitted to grant loans to their clients. EU passport provisions apply. Non-EU credit institutions require special authorisation by the Bank of Greece. Lending is also permitted between members of the same corporate group. Furthermore, Law no. 4354/2015 regulates management and transfer of claims from NPLs/NPEs. Said law introduces the company types of: (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. L.M.C.s must be granted a special operating licence by the Bank of Greece in relation to NPLs' management. L.T.C.s are not required to obtain any operating licence from the Bank of Greece. However, if an L.T.C. includes loan/credit acquisitions within its business scope, it must enter into a loan management agreement with an L.M.C. which is properly licensed and supervised by the Bank of Greece.

Non-proper authorisation results in administrative sanctions, including but not limited to pecuniary sanctions (i.e. fines) 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?

There are no other material considerations.

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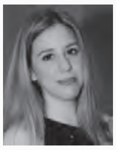

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Sardelas Petsa Law Firm has established a leading position in Greek legal services as a business law firm with a strong international dimension, and is well known in Greece and abroad for its top drawer specialised professional service in complex cross-border 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 highest 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 was selected on the IFLR Awards shortlist for the most innovative debt and equity-linked transaction in Europe.

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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 fund-raising 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 OJK Regulation No. 35/POJK.05/2018 on Finance Companies, which expands the business scope of finance companies by allowing them to extend cash loan financing to borrowers up to a certain threshold and subject to certain requirements.

1.2 What are some significant lending transactions that have taken place in your jurisdiction in recent years?

One of the most highlighted transactions was the completion of the three-stage MUFG Bank Ltd acquisition of PT Bank Danamon Indonesia, Tbk, marking an exemption from the 40% cap on foreign ownership of Indonesian banks, which involved a follow-on merger between Bank Danamon with PT Bank Nusantara Parahyangan, Tbk. The total amount of that transaction was around 680 billion yen – the highest value transaction by a Japanese company in a foreign bank, resulting in MUFG Bank holding a 94.1% share in Bank Danamon.

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 general meeting of 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. As a general rule under Indonesian company law, if a company's guarantee obligation constitutes more than 50% of the company's net assets, the company is required to obtain approval from its general meeting of shareholders. In addition, if the guarantee is provided in favour of foreign creditors, the guarantor must submit a periodical report to the Central Bank of Indonesia of its contingent liability.

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. The guarantor may also need to check any negative pledge/covenant under its existing agreements that may contractually impose certain limitations relating to providing a guarantee for any other party's payment obligation.

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 assets require different types of security interests and agreements.

Mortgage for Land (with or without any building upon the land)
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. On 21 June 2019, the Ministry of Agrarian and Spatial Plan/National Land Agency introduced a new regulation on electronically integrated mortgage service ("**E-mortgage**"). The E-mortgage is intended to accelerate the service process of registration, assignment, rectification, amendment and deregistration of mortgage through an electronic system. One of the features of the E-mortgage system is that a qualified secured creditor can directly access the E-mortgage certificate and attach it to the relevant land certificate. However, the E-mortgage system is still in the initial stage of development and there remain some technical and practical issues that have not been appropriately addressed by the new regulation. For this reason, for the time being, the mortgage process remains a manual procedure, although some BPNs have commenced the implementation of the E-mortgage system on a limited basis (for very simple bilateral loans and mortgage transactions) as an alternative to the manual procedures.

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). Pledge over tangible assets requires the secured objects to be kept in the pledgee's possession. Once the possession is re-transferred to the pledgor, the pledge will cease.

Fiduciary Security
Unlike a pledge, fiduciary security over tangible assets allows for the security provider to keep the secured objects under its possession and utilise them for its day-to-day operations. 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 to five business days 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 and procedures as described in question 3.2 above. Mortgages apply to land (either with or without buildings upon the land), and fiduciary security applies for buildings/plant (secured separately from the land), 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 are for the creation of the hypothec deed and the registration fees, generally calculated based on the size of the vessel, payable to the relevant Vessel Registration and Listing of Transfer of Transfers of Ownership Official (*Pejabat Pendaftar dan Pencatat Balik Nama Kapal*).

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 2.4.

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 and the secured object(s) remain in existence until 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 3.2–3.9.

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?

As per our answer to question 5.1 above, the security agent role is common in Indonesian financing.

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, 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. As for withholding tax-related matters, this needs to be assessed and confirmed by a qualified tax consultant.

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 merits of the case 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 and provided that there is no objection from any interested party.

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 legal 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 on 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 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 of 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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Ireland

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1 Overview

1.1 What are the main trends/significant developments in the lending markets in your jurisdiction?

There has been a growing awareness of the importance of sustainable finance as part of a multipronged approach to tacking climate change, both from an international and national perspective.

Sustainable finance is the provision of finance to investments taking into account environmental, social and governance consideration. On 25 September 2019, the Council of the EU announced that it has agreed its position on a proposed regulation (the "**Sustainable Investment Regulation**" or "**SIR**") on the establishment of an EU-wide classification system or "taxonomy", which will provide businesses and investors with a detailed framework to identify to what degree economic activities can be considered environmentally sustainable. At present, there is no common classification system at EU or global level which defines what is an environmentally sustainable economic activity. According to the Council's position, the taxonomy should be established by the end of 2021, to ensure its full application by the end of 2022. The SIR represents a significant step towards a legally binding standard for sustainable finance.

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 with the most cross-border activity. Over the past 10 years, Ireland has seen a substantial change in its debt funding landscape with the emergence of a large number of non-bank lenders into the Irish market. As a result, the Irish lending market is more diverse than ever before and has led to a range of blended finance solutions for Irish companies.

There have been notable legal/regulatory developments too – for example, unregulated entities (other than securitisation special purpose vehicles which are exempt) that hold legal 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**") pursuant to the Consumer Protection (Regulation of Credit Servicing) Act 2018 (the "**2018 Act**") (discussed at question 10.1 below). One potential unforeseen/unintended consequence of the 2018 Act is the impact that it may have on the status of UK-regulated lenders in Ireland post-Brexit. In the event of a "hard Brexit", UK-regulated lenders would likely lose the right to cross-border passport under EU financial services legislation and would become "unregulated" for the purposes of Irish law. There is a risk in this scenario that the Irish credit servicing regime, which effectively imposes an obligation that Irish borrowers that obtained loans from regulated lenders must always interface with a regulated firm for the life of that loan, may lead to UK-regulated lenders inadvertently finding themselves in breach of the 2018 Act.

Although the UK left the EU on 31 January 2020, the impact of Brexit on Ireland will not become clear until the end of the current transitional period (which runs until 31 December 2020) but may yet present significant opportunities for the Irish lending market. This is particularly given Ireland's common law system and its geographic location, being close to the UK 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. Real estate finance has continued to be an area of particular focus, especially commercial investment and residential development (the latter being a sector in which non-bank lenders have been notably active). Standout transactions in this space include Heitman's acquisition of The Circle Collection of 214 residential and three commercial properties, Fine Grain Property's financing of the Westpark business campus in Shannon and multiple financings of high-profile assets and developments by Fairfield Real Estate Finance. Other noteworthy transactions include the securitisation of the Seniors Money Group's book of equity release mortgages where Dillon Eustace acted for Deutsche Bank AG, London Branch and, in the sustainable finance space, a significant loan for a leading utility company provided by a large European bank where Dillon Eustace acted for the lender.

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 be 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 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 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.

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.

In addition, as part of the implementation of the EU's Anti-Tax Avoidance Directives ("**ATAD**"), anti-hybrid rules have been recently introduced into Irish tax legislation. Broadly speaking, these rules are intended to prevent arrangements that exploit differences in the tax treatment of a financial instrument or an entity under the tax laws of two or more jurisdictions to generate a tax advantage. The rules apply to arrangements between associated enterprises and to certain "structured arrangements". The new legislation is effective for relevant payments made or arising on or after 1 January 2020.

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.

With the UK's departure from the EU on 31 January 2020, under the transitional arrangements agreed to 31 December 2020, a judgment made in England should be capable of enforcement in Ireland without any declaration of enforceability being required pursuant to Regulation (EU) No. 1215/2012 ("**Brussels I**"). That being the case, judgments made in England should be treated effectively as a judgment made by a court in Ireland. The position remains to be finally resolved 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 division of the High 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 and where there has not been undue delay in applying to have the case heard by the Commercial Court.

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 for more than €10,000 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 a 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 EU Insolvency Regulations, 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. A lender's rights against a guarantor of the debtor company are also preserved if the lender complies with certain requirements.

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 an unsecured claim 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 dominant intention of 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 2018 Act. While not imposing any additional licensing requirements, the 2018 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, which 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 above, 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).

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The authors would like to acknowledge the assistance of their colleague Shona Hughes in the preparation of this chapter. Shona acts on a wide range of banking transactions for both financial institutions and corporates, both domestic and foreign, on an extensive range of banking law matters. She provides advice on matters in relation to borrowings and the provision of guarantees and security in respect of such borrowings, pre-conditions of security documentation and perfection of security.
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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 adopted by the Italian Government at the beginning of 2019 (after consultation with the Parliamentary Committees) and is expected to come into force in August 2020, save for certain specific provisions which entered into force in March 2019. 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 proposed reform enters into force, the current provisions of the Italian bankruptcy law still continue to apply (for further details, see Section 8). For the sake of brevity, this chapter does not include the changes which will be brought by the abovementioned reform.

Finally, the Italian lending market is expected to be affected by Brexit.

With the ratification of the agreement for the UK's withdrawal from the EU, as of 1 February 2020, the UK is no longer a member of the EU. With the purpose of avoiding a cliff-edge scenario in the bilateral relations between the EU and the UK, a transition period until 31 December 2020 was provided in the withdrawal agreement. During such transition period, negotiations will be carried out between the UK and the EU in order to regulate their future bilateral relations, and EU legislation will continue to apply to the UK, including in regard to access to the financial services market. In Italy, contingent transitional measures to ensure the operational continuity of intermediaries and markets are contained in Law Decree No. 22 of 25 March 2019, converted into Law 41 of 20 May 2019.

Upon expiration of the transition period, 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?

Some significant transactions that have taken place recently are as follows:

- A EUR307 million senior secured loan facility granted by a pool of lenders in favour of Brebemi, the strategic A35 toll road which connects Brescia, Bergamo and Milan, in the context of a significant refinancing involving a EUR1.679 billion issue of four series of landmark project bonds (Allen & Overy advised both the lenders and the bookrunners).
- A refinancing of Prysmian S.p.A.'s existing EUR1 billion revolving credit facility granted by a pool of leading Italian and international banks – including Banca IMI, BNP Paribas, Citi, Crédit Agricole CIB, ING and Mediobanca (advised by Allen & Overy).
- An ESG-linked back-up revolving credit facility, in the form of a committed facility amounting to EUR1.5 billion granted to Terna S.p.A. by a pool of banks (advised by Allen & Overy) comprising UniCredit, Banca IMI, BNP Paribas and Cassa Depositi e Prestiti.

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 judgment" 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 acknowledgment 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, 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, insurance companies incorporated and licensed under the laws enacted by EU Member States 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, securitisation companies under Law No. 130 of 30 April 1999, insurance companies incorporated and licensed under the laws enacted by EU Member States and collective investment funds (OICR) established in EU or EEA countries included in the white list; (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 EUR200 (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.?

Security agreements which have to be notarised may be either a public deed executed before a notary or a document with the signatures of the parties certified by a notary. 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 blacklist 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

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". After expiration of the transition period provided in the withdrawal agreement between the UK and EU, the Recast Brussels Regulation will cease to apply to the UK unless otherwise agreed. At this stage, it is still unclear whether the Brussels Convention of 1968, the bilateral treaty entered into between the UK and Italy in 1964 or Law No. 218 of 31 May 1995 will apply.

Non-European countries (e.g. New York)

The acknowledgment and enforcement of decisions issued by courts belonging to jurisdictions outside of the EU is generally governed by Law No. 218 of 31 May 1995, unless international agreements are in place. 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 are aimed at ascertaining some criteria set out by Law No. 218 of 31 May 1995 and do not imply any re-examination of the merits of the case. Such proceedings usually last one to one-and-a-half years, 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 insolvency proceedings (*i.e. concordato preventivo* and *accordi di ristrutturazione*), 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 claims accrued during the procedure (*prededucibili*), 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, requirements and authorisation from the Bank of Italy, 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

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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. Please note that fundamental reform of the Civil Code of Japan will be enforced as of April 1, 2020, and it may affect lending transactions.

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 has been one of the key focuses in Japan.

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. Please note that, because the Civil Code was amended and will take effect as of April 1, 2020, if an assignment agreement is executed after April 1, 2020, such assignment of claim is valid even if there is 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 filing (up to 1,000 movables)), and (iii) claim assignment registration (JPY 7,500 per filing (up to 5,000 claims) and JPY 15,000 per 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. Please note that on August 30, 2019, the tax treaty between the US and Japan was amended.

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. 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 foreclose 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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1 Overview

1.1 What are the main trends/significant developments in the lending markets in your jurisdiction?

Banking deposits in Jersey are on the rise (£139.2bn as at September 2019 according to the figures from the Jersey Financial Services Commission). The headquarters of a number of international banking organisations remain in Jersey and following the completion of post-Vickers ring-fencing, deploying balance sheet capital through lending products continues to be high on the agenda for some of these banks. That means, for most, seeking out more international rather than local deals.

The absence of significant European M&A activity has continued to depress the leveraged finance market, although the outlook for 2020 is stronger with considerable private equity dry powder available.

Brexit has influenced the lending activity in Jersey, but only to the extent that it has affected the cross-border deals which are led from the City. Jersey remains to a great extent a "no change" jurisdiction as it is not a member of the EU. The actual impact of Brexit is therefore only to be felt via the aftershocks emanating from the European economies.

Significantly Jersey was given a clean bill of health on matters of beneficial ownership (UK Parliamentary Review and the Financial Action Task Force ("**FATF**")), tax practices (OECD), economic substance (ECOFIN) and is set to align itself with the EU's 5th Anti Money Laundering Directive, clearly demonstrating a commitment to being a cooperative jurisdiction.

New fund formations have been steady and the financing of such funds through subscription facilities, NAV or hybrid products as well as GP leverage (whether by debt or equity) remains an important part of the Jersey lending market.

The outlook for high-yield bonds is very positive going into Q1 2020.

1.2 What are some significant lending transactions that have taken place in your jurisdiction in recent years?

Due to the nature of the work, many transactions are highly confidential. Carey Olsen is active on 35 global bank panels. As part of bank panel terms, we are unable to disclose the names of these 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)?

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 detail 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?

There are two main forms of security for real estate:

- **Hypothecs**. A hypothec is a right of security held by a creditor over the property of a debtor without possession of it, and is created either by agreement or by operation of law. A hypothec can attach only to immovable property; a hypothec can therefore encumber freehold and flying freehold property, and contract leases (but only where the terms of the lease expressly permit hypothecation). Paper leases cannot be hypothecated. Hypothecs can be specific (that is, over

one property) or general (that is, attaching to all immovable property in Jersey owned by the debtor at the date of registration). There are two common types of hypothec:
- **judicial hypothec.** This type of hypothec is created by the registration of an acknowledgment document (a "*billet*") in the Jersey Public Registry. The instrument of debt or obligation (for example, a bond, promissory note or guarantee) is not itself registered, rather the *billet* simply acknowledges the source of the indebtedness; and
- **conventional hypothec.** This type of hypothec is created by the passing of a contract before the Royal Court, which contract sets out the terms of the borrowing and includes an express acceptance of the hypothec from the borrower. Once passed before Court, the contract is registered in the Jersey Public Registry, and is available for public inspection.

- **Share security**. In relation to share transfer properties, lenders require security in the shares of the company that owns the property. 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 £165 if the registration will run longer than 20 years (there is no concept of infinite registration);
- discharge – no fee;
- amendment of registration – £25;
- extension of period of registration – same cost scheme as above;
- global change of multiple registrations (other than expiry date) – £110;
- 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 on 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 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 four to six 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 assets of 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 under the Judgments (Reciprocal Enforcement) Law 1960 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 if pursued under the Désastre Law 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 debtor 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?

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 it 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. *Dégrèvement* is a process whereby 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, having the following features:

(a) The process is complicated and is carried out under Jersey's 1880 law on immovable property. It can only be commenced by a secured creditor and results in one creditor keeping the property.

(b) The creditor taking the property must pay off all earlier (i.e. prior ranking) 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 priority ranking 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 in respect of secured obligations 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 it is either:

- just and equitable; or
- 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 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 FATF confirmed that Jersey is compliant or largely compliant with 48/49 of the FATF recommendations in respect to anti-money laundering and combatting 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.

Robin Smith 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 has experience of acting on a number of high-value and multi-jurisdictional transactions.

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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.

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Antoine Fortier Grethen

1 Overview

1.1 What are the main trends/significant developments in the lending markets in your jurisdiction?

While the fund market (and related financing) remains at a very high level, and continues to grow, the trend for borrower-friendly and sponsor-led transactions has been confirmed for financing arrangements. An increase in the number of debt restructurings has also been noted.

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. The most notable was the financing of Advent International's public-to-private acquisition of Laird PLC, which is the first-ever all-U.S. dollar-denominated financing documented under English law and sold into the U.S. One other significant deal was the financing of the acquisition by Ion Investment Group of the Acuris group, which includes the financial information services MergerMarket and Debtwire.

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 that 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. However, the fact that the act is *ultra vires* 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 law pledges (*gage civil*), commercial law 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, des Domaines et de la TVA*) and with the mortgage office (*Bureau des Hypothèques*) in charge of the 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 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, des Domaines et de la TVA*) and with the mortgage office (*Bureau des Hypothèques*) in charge of the 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 over real property and pledges over an ongoing business concern are valid for 10 years following the date of their registration with the mortgage office (*Bureau des Hypothèques*) and 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 in relation to, 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.

Mortgages and pledges over an ongoing business concern must be registered with the tax administration (*Administration de l'Enregistrement, des Domaines et de la TVA*), which triggers an *ad valorem* registration duty (*droit d'enregistrement*) of 0.24% on the principal amount of the underlying secured obligation. In addition, mortgages and pledges over an ongoing business concern must be registered with the Luxembourg mortgage office (*Bureau des Hypothèques*) in charge of the district in which the asset or business is located, for which an *ad valorem* inscription duty (*droit d'inscription*) of 0.05% on the principal amount of the underlying secured obligation, notary fees and mortgage registrar fees are payable.

In case of renewal of mortgages over real property and pledges over an ongoing business concern (see question 3.3), similar registration and inscription duties will apply.

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). Most account banks in Luxembourg apply additional fees in relation to pledges over bank accounts.

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 and regulator regarding a new pledgee for the creation of a pledge over an ongoing business concern may take up 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). Typically, powers of attorney are granted for the execution of mortgage deeds and, depending on the place of execution or registration of the grantor of the power of attorney, additional notarisation and apostille requirements apply to such powers of attorney.

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") are met (this is rarely used in practice, and detailed in the law of 10 August 1915 on commercial companies, as amended (the **Company Law**)). 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 as not being 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.

Mortgages are, by operation of law, subject to notarisation and mandatory registration formalities entailing (i) registration duties (*droits d'enregistrement*) of 0.24% on the principal secured amount, (ii) inscription duties (*droits d'inscription*) of 0.05% on the principal secured amount payable to the mortgage office (*Bureau des Hypothèques*), and (iii) notary fees and mortgage registrar fees.

Under certain circumstances, loans and security documents are subject to mandatory registration formalities. Even if registration is not required by law, loans or security documents can be subject to voluntary registration. In case of registration, registration duties (*droits d'enregistrement*) will apply in the form of a fixed amount or an *ad valorem* amount depending on the nature of the document and the mortgaged asset (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 once the UK has effectively left the EU and absent a UK/EU Withdrawal Agreement.

According to the Brussels Ia Regulation, under no circumstances may a foreign judgment 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 the commercial procedure rules, a decision can be obtained within six to 18 months. If the suit is filed pursuant to the civil procedure rules, 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 security interests over 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 included in the mortgage deed or if the mortgagee is not a first ranking beneficiary, it will have to organise a real estate attachment procedure (*saisie-arrêt*) involving court hearings, in order to enforce 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 conduct 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 such award 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 as being 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 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 case 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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1 Overview

1.1 What are the main trends/significant developments in the lending markets in your jurisdiction?

This year will be remembered as a landmark for Mozambique, for both tragic and positive reasons.

In March and April, the country was hit by Cyclones Idai and Kenneth, two of the worst disasters ever experienced in Mozambique's history, resulting in thousands of lost lives and millions of dollars' worth of damage. At the other end of the spectrum, June saw the landmark agreement of a final investment decision (FID) by Anadarko Petroleum for the $20bn development of the Area 1 Mozambique LNG project, the largest in Africa. Mozambicans are hopeful that gas revenues will prove transformational for the country's economy and positively impact the lending market, which is still struggling to reverse a four-year slowdown in growth.

Anadarko's FID is not the first of its kind in Mozambique; Italy's ENI gave the final go-ahead for its $10bn Coral South floating liquefied natural gas (LNG) project in 2017. But while that project is expected to have an annual production capacity of about 3.4 million tonnes, Anadarko's development is expected to have an annual capacity of 12.9 million tonnes. A further FID for the development of the Rovuma LNG project, led by ExxonMobil, is expected by the end of 2019, for two plants with a capacity of more than 15 million tonnes per year. The signing of the FIDs is the clearest sign yet of progress in the long-awaited development of Mozambique's gas reserves, nearly 10 years after they were first discovered. Such gas projects are expected to generate $95bn of revenue over 25 years for Mozambique – more than seven times the country's current gross domestic product (GDP).

Fast-forward a few years, and the picture in 2019 looks far more stable for Mozambican lenders. Even as economic growth has continued to slow, no further banks have had their licences revoked. Moza Banco is on the verge of completing a restructuring, which has involved new external investment and a merger with Banco Terra Mozambique, another local lender. The balance of international reserves is at acceptable levels for the import of goods and services, excluding for the execution of bigger projects. This resilience of our economy is a result of the combined efforts of several sectors. The country's six largest lenders – which between them hold between 85% and 90% of assets, loans and deposits – saw combined profits rise for the second consecutive year with returns on assets and returns on equity at their highest levels since 2011. Yet banks' NPL ratios, while lower in 2018, remain near multi-year highs, with little sign of an immediate uptick in lending to the wider economy, in spite of lower interest rates. With 19 banks serving a population of about 28 million (alongside eight credit co-operatives and nearly 430 microfinance operators), further consolidation in the sector seems inevitable among smaller lenders.

Mozambique's banking sector is dominated by lenders that are either subsidiaries of foreign banks or count international investors as their largest shareholders. Of the country's six largest banks – *Banco Comercial e de Investimentos* (BCI), Millennium bim, Standard Bank Mozambique, Barclays Bank Mozambique, Moza Banco and Banco Unico – only Moza Banco's majority shareholders are from Mozambique.

The combined net profit of the country's six largest banks grew to $285m in 2018, a 23% rise on 2017, according to figures compiled by analyst Eaglestone Securities. The growth in profits during 2018 came despite a slowdown in growth in net interest income (the largest contributor to revenues by far), which rose just 4.4%, compared with an average annual growth of 28.4% between 2012 and 2017. Total revenues rose 4.7% to $883m.

The rise in profits came largely through a significant drop in loan impairments following a spike in 2017, with *Banco de Moçambique* cutting rates by 325 basis points during 2018.

1.2 What are some significant lending transactions that have taken place in your jurisdiction in recent years?

The past three years have not been easy for Mozambique's banks. Previously one of the world's most rapidly expanding economies, growth has slowed since the revelation in 2016 of a series of hidden government debts. This prompted the International Monetary Fund to cut off support to the country, triggering a collapse in the local currency and a default on its debts, plunging the wider economy into crisis. Faced with such pressures, the *Banco de Moçambique*, the country's central bank, was forced to intervene to rescue Moza Banco, the country's fifth largest lender by assets, and revoke the licences of three lenders in 2017.

That same year, the central bank introduced tougher regulations for lenders, including lifting the required solvency ratio to 12% from 8%, and the Tier 1 capital ratio to 10%. Banks are now required to have a daily liquidity ratio of no less than 25%, and to disclose data on metrics such as capital, asset quality, solvency ratios and credit risks on a more regular basis.

But the signing in June of a final investment decision (FID) by Anadarko Petroleum for the $20bn development of the Area 1 Mozambique LNG project, the largest in Africa, may prove a catalyst for confidence in the economy, especially in lending to small and medium-sized enterprises (SMEs).

Mozambique's stock exchange, the *Bolsa de Valores de Moçambique* (BVM), celebrated its 20th anniversary in 2019. The exchange marked the milestone with the initial public offering (IPO) of a stake in HCB, operator of the Cahora Bassa hydroelectric dam, the largest in southern Africa. Yet while the IPO, the country's largest in several years, is expected to be the first of many, the BVM remains a shallow market at heart.

The BVM will be hoping that HCB's listing provides fresh impetus to the trading of stocks in the country, on one of Africa's smallest bourses. The BVM had only 51 listed securities at the end of 2018, with 42 of those either treasuries or corporate bonds. Just eight companies had listed shares on the bourse ahead of the HCB IPO. The bourse has a market capitalisation of about 96.6bn meticais in mid-July 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)?

As a general rule, the 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 to be null and void.

The provision of the guarantee or security with disproportionate small (or no) benefit to the company may give rise to a 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 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 group relationship (if any) with the entity benefiting from the provision of the guarantee.

Additionally, the Mozambican Commercial Code set forth that guarantees/security shall be registered on an internal record book of 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 to movable assets, assigned to secure lending obligations, must be registered at the *Central de Registo de Garantias Mobiliárias*, for publicity to be given and enforceable against third parties. Such registry is valid for an initial period of five years, and shall be renewed at guarantor's request.

2.5 Are net worth, solvency or similar limitations imposed on the amount of a guarantee?

No, there 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, are subject to prior authorisation by 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 by 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, aircraft, 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 generic security (i.e. over the assets of a given entity generically) 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. At least, the security agreement must 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 the mortgage 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 the securing and secured parties, with the respective signatures certified by a public notary.

In relation to mortgages and pledges or escrow of incomes, it is 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.

In what concerns mortgage over machinery and equipment thereof, it 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, in respect of mortgages over industrial units, an inventory of all assets and equipment will also be required and 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 is 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 against 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 per the creation of the pledge over receivables, the creation of a pledge over cash deposited in a bank account will require 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 public limited liability companies (*sociedades anónimas*), whose share capital is represented by shares (*acções*), the perfection requirements for pledge of shares include: the endorsement of the share certificates by the pledger (debtor); registration of the pledge in the company's register book; 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 the case that 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 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 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 maturity 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 maturity 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 cases where a foreign lender entity is involved, then 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 cases where powers of attorney 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 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 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, under 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 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?

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 the 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 the proceeds of a claim under a guarantee or the proceeds of enforcing security, there are no specific withholding tax rules.

In fact, in the 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 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 national lenders, which are notarial and registration fees, and taxes applied.

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, and does not refer to non-waivable rights, neither to land rights over properties located in Mozambique, nor to insolvency procedures or to the validity or enforceability of corporate resolutions concerning Mozambican legal entities.

In cases where 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 the judgment can be made, although 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 of 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 out 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;
(vi) subordinated credits.

In the 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 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 bound 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.

The 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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Netherlands

Mandeep Lotay

Tim Elkerbout

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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 the following recent trends and developments.

(a) The excess supply of credit has put pressure on deal terms. This is becoming even more apparent due to the entry of direct lenders/fund lenders in the financing markets.

(b) Reflecting the refinancing wave in Europe driven by the low cost of funding, there has been a significant number of refinancing transactions.

(c) Given the amount of competition to lend and the supply of money, reducing the margin payable on a loan by borrowers is a big trend seen by both the European and Dutch markets.

(d) Firms in the Dutch market that have international platforms and which are not just local players continue to flourish and work on truly international banking mandates.

(e) Both in classic leveraged finance and real estate finance, private equity players play an increasingly important role in acquisition financings and also in the provision of funding through their credit funds where traditional banks are struggling to be competitive in certain situations.

1.2 What are some significant lending transactions that have taken place in your jurisdiction in recent years?

Examples of significant lending transactions in the Dutch market include:

(a) the financing of Netherlands-headquartered TIP Trailer Services, a leading equipment service provider specialising in trailer leasing, rental, maintenance and repair;

(b) the financing of the acquisition by CVC Capital Partners of the TMF Group, a global provider of compliance and administrative services; and

(c) the financing of the acquisition of (former) Dutch listed company Wessanen N.V. by a consortium consisting of PAI Partners and the existing majority shareholder Charles Jobson through a recommended all-cash public offer.

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 principle, yes, a Dutch company can guarantee borrowings of one or more other members of its corporate group, provided that the objects clause in the guarantor's articles of association covers the issuing of guarantees. Restrictions apply; please refer to the responses to questions 2.2–2.5 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?

Under Dutch law, (the directors of) a Dutch company should in principle act in the interests of the company and its business. Additionally, the interest of the group to which the company belongs may be considered. In a group context, the common rationale as supported in case law is that the guarantor, as a shareholder or affiliated (group) entity, will benefit from the credit facility for which it assumes liability. In this context, it is generally held that group guarantees, and in particular parent guarantees, for debt of a group entity and/or subsidiary, serve the interests of an individual group company.

For purposes of establishing whether or not a guarantee granted in the context of a group financing serves the individual corporate interest of the guarantor, the following factors play a role: (i) whether the guarantor benefits from the loan (i.e., whether it will have access to the credit, either directly or indirectly); (ii) how much risk will be taken by entering into the guarantee and whether the group will be able to comply with its obligations for which the guarantee is provided; (iii) whether other group companies also provide a guarantee and/or accept joint and several liability; and (iv) what the consequences for the company would be if the loan was not granted to the group.

Finally, although there is no balance sheet insolvency test in the Netherlands, directors of a guarantor may be personally liable towards a creditor or a group of creditors of such company if they decided to continue the business past a certain point in time and such a decision resulted in damages to the creditors as a result of the company having insufficient assets against which the creditors can take recourse for the damages incurred. This may also lead to the guarantee being voided by creditors or the bankruptcy trustee of the guarantor on the basis of fraudulent preference.

2.3 Is lack of corporate power an issue?

Pursuant to Article 2:7 of the Dutch Civil Code, any guarantee given by a legal entity may be nullified by the legal entity itself or its liquidator in bankruptcy proceedings if the legal act was outside the company's objects and the other party to such legal act was or should – without investigation – have been aware of this. The determination of whether a legal act is within the objects of the company may not be based solely on the description of these objects in the company's articles of association, but must take into account all relevant circumstances, including in particular the question of whether the interests of the company are served by the relevant legal act.

In any event, if the contemplated transactions in the light of the benefits, if any, derived by the company from such transactions, would have a disproportionate adverse effect on the interests of the company, these transactions may be found to be outside the objects of the company and the counterparty may be held to have been aware of this.

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 corporate guarantee. In principle, the only formalities are at the level of the guarantor and are limited to board approval and, if required on the basis of the articles of association, shareholder approval and approval of the supervisory board. Finally, if there is a works council with jurisdiction over the guarantor, it may have the right to advise on entering into the guarantee.

2.5 Are net worth, solvency or similar limitations imposed on the amount of a guarantee?

If the guarantor is a legal entity, no net worth, solvency or similar limitations apply to the amount of a guarantee. However, please refer to our response to question 2.2.

2.6 Are there any exchange control or similar obstacles to enforcement of a guarantee?

Dutch law does not provide for any 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 pursuant to a right of pledge (*pandrecht*) or mortgage (*hypotheek*). The most common collateral being pledged are moveable assets, shares and receivables. Bank accounts, insurance policies, intellectual property rights and certain subsidy grants are also capable of being pledged. Mortgages can only be established on property subject to registration, i.e. real estate or registered property (for example seagoing vessels and aircraft). In addition, security over financial collateral can be created through a financial collateral arrangement (*financiëlezekerheidsovereenkomst*).

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 practice, omnibus pledges are used for creating non-notarial security documents (i.e., security over receivables, bank accounts, insurance policies, intellectual property rights). Please also see question 3.4. It is not possible to conclude a general security agreement for all types of assets in the Netherlands; a separate deed of pledge or mortgage is required for creating security over shares or real estate. The specific requirements for creating a right of pledge or mortgage depends on the (type of) asset.

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 located in the Netherlands. This security is created pursuant to a notarial deed of mortgage executed before a Dutch civil law notary. This notarial deed must be registered with the Dutch Land Registry Office.

Collateral security over plant, machinery and equipment (moveable assets) located in the Netherlands can be taken by way of a:

- possessory pledge, where possession of the collateral is transferred from the pledgor to the pledgee or to a particular third party agreed upon by the pledgor and the pledgee. A possessory pledge does not require notarisation or registration; or
- a non-possessory pledge, where possession of the collateral remains with the pledgor. The deed of non-possessory pledge must either be drawn up in notarial form or registered with the tax authorities for the pledge to be valid.

As a possessory pledge requires the pledgor to hand over his collateral to the pledgee, non-possessory pledges are more usual. It is common practice to create a non-possessory pledge by way of a private deed of pledge to be subsequently registered with the Dutch tax authorities.

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 created by means of a right of pledge. There are two types of pledges over receivables: a disclosed right of pledge; and an undisclosed right of pledge, depending on whether the debtor of the receivable has been notified of the pledge. A disclosed pledge does not require notarisation or registration. An undisclosed right of pledge must either be drawn up in notarial form or registered with the Dutch tax authorities for the pledge to be valid.

When taking security over receivables by way of an undisclosed pledge, the pledge will only capture receivables arising directly from existing legal relationships. Receivables arising from a legal relationship that comes into existence after the execution of the deed of pledge fall outside the scope of the original (undisclosed) pledge. For purposes of creating an up-to-date security package, parties will need to 'repeat' the creation of the pledge by way of executing a supplemental pledge (which is to be registered with the Dutch tax authorities). For efficiency purposes, Dutch banks have established a practice whereby a master deed of pledge (*verzamelpandakte*) is created, in which the bank agrees with the pledgor that all its current and future receivables are pledged to the bank and in which the pledgor grants an irrevocable power of attorney to the bank, authorising the bank to create (on behalf of the pledgor) and register one daily supplemental pledge on behalf of all pledgors that granted such power of attorney.

3.5 Can collateral security be taken over cash deposited in bank accounts? Briefly, what is the procedure?

Cash deposited in a bank account qualifies as a personal claim, capable of being pledged. Personal claims are in principle pledged by deed and notification of the pledge to the debtor of the pledged claim (disclosed pledge). However, it is also possible to create an undisclosed right of pledge by way of (i) a private deed of pledge registered with the Dutch tax authorities, or (ii) a notarial deed of pledge.

Pursuant to the Dutch general banking conditions, a Dutch account bank has security interests in the bank account of the pledgor (for example a right of set-off and a right of pledge) and needs to provide consent for the creation of a right of pledge. It is therefore recommended to involve the account bank in the creation of such a disclosed pledge on a bank 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?

It is possible to take security over shares. In principle, shares in a Dutch private limited liability company (*besloten vennootschap met beperkte aansprakelijkheid*) and a Dutch public limited liability company (*naamloze vennootschap met beperkte aansprakelijkheid*) are registered shares (*aandelen op naam*). Shares in a Dutch public company can also be issued as bearer shares (*aandelen aan toonder*) subject to the deposit of a global certificate with a custodian bank or intermediary. Bearer shares hardly exist in the Netherlands.

To create a right of pledge over registered shares, a notarial deed is required. The articles of association may prohibit or restrict the encumbering of the shares and/or the transfer of voting rights attached to the shares. It is common that the rights to collect dividends and to exercise voting rights remain with the shareholder/pledgor until the occurrence of an event of default (which is continuing) and notice given thereof by the pledgee. A right of pledge over shares in a listed company can be created pursuant to a non-notarial deed and acknowledgment by the company.

To the extent shares in a Dutch public company are deposited in a securities account, they can be pledged accordingly. 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 or intermediary.

The shares are not in certificated form, but registered in the shareholders' register of the BV or NV. Any right of pledge over the shares should be duly recorded in the shareholder's register.

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 qualifies as a moveable asset. It is therefore possible to take security over inventory located in the Netherlands by way of a possessory or non-possessory pledge. Please see question 3.3 for the description of the procedure.

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)?

This is possible if and to the extent that such transaction is within the corporate interest of the company and the corporate objects of the company allows such transaction. For Dutch public limited liability companies, financial assistance rules should be complied with (see 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?

Notarial fees are charged for all security created pursuant to a notarial deed, executed before a Dutch civil law notary. Notarial costs are normally charged in a manner consistent with legal fees; i.e. an hourly rate or a fixed-fee arrangement can be agreed upon. Compared to other jurisdictions, Dutch notarial fees are generally considered reasonable.

Registration fees are charged by the Dutch Land Registry Office for the registration of mortgages.

No stamp duties are levied on security rights over assets.

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 is a straightforward process, which does not involve a significant amount of time or expense.

3.11 Are any regulatory or similar consents required with respect to the creation of security?

Generally, negative pledge provisions may apply with respect to receivables, movables and shares, requiring the consent of the debtor/owner for creation of the security. In case of real estate that is to be encumbered with a mortgage, it is possible that the landowner will have to give its consent.

3.12 If the borrowings to be secured are under a revolving credit facility, are there any special priority or other concerns?

No, such claims rank *pari passu* with any other secured facilities.

3.13 Are there particular documentary or execution requirements (notarisation, execution under power of attorney, counterparts, deeds)?

Security over real estate can only be created pursuant to a notarial deed, and for share pledges this is generally also the case (although exceptions apply, see question 3.6).

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 Article 2:98c(1) of the Dutch Civil Code, a Dutch public company (an NV (*naamloze vennootschap*)) may not provide collateral, guarantee the price, act as surety or otherwise bind itself jointly or severally for the benefit of third parties, for the purpose of the subscription for or the acquisition of shares by third parties in its own capital or of depositary receipts issued therefor. The limitation does not apply to Dutch private companies (BVs), although the articles of a BV may still include provisions regarding financial assistance as a remnant of the financial assistance prohibition that used to apply to a BV (prior to 2012) on the basis of a provision equivalent to Article 2:98(c)(1) of the Dutch Civil Code. Where the text in the articles of association of a BV still includes a provision regarding financial assistance, it is advisable to amend the articles of association prior to the entering into of a transaction that may qualify as a violation of such provision.

(b) Shares of any company which directly or indirectly owns shares in the company
It is expressly provided that the prohibition set out above also applies to the (Dutch and foreign) 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 companies.

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 does not have an identical concept or doctrine to the concept of a trust. However, any trust validly created under its governing law is recognised by the Dutch courts pursuant to legislation implementing the Hague Trusts Convention. The agency concept, as a contractual arrangement, is recognised under Dutch law and also a common feature in Dutch syndicated lending transactions. Under Dutch law, security can in principle only be created for the benefit of the creditor(s) of the claim. As such, for purposes of enabling a security agent to enforce security created under Dutch law and subsequently apply the proceeds from the collateral to the claims of all the lenders, a parallel debt structure is used.

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 Netherlands, a parallel debt structure is the standard mechanism in financing transactions to ensure that security interests governed by Dutch law can be held by a security agent for the benefit of the lenders. In a parallel debt structure, a borrower/guarantor at any time owes to the security agent in its individual capacity (i.e., acting in its own name and not as agent or representative of the lenders) an amount equal to the aggregate amounts owed by such loan borrower/guarantor to the syndicate of lenders under the loan documents (the 'parallel debt'). All security interests governed by Dutch law vest in the security agent as security for the parallel debt claim. No security interests are created in the name of the individual lenders. Each lender has a contractual claim against the security agent for payment of the amounts owed by the security agent to each of the lenders, as catered for in the loan documentation/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?

When transferring all rights and obligations under a contract (*contractsoverneming*), for purposes of establishing the transfer requirements, Dutch private international law in principle follows the governing law of the contract. If Dutch law applies, the consent of the debtor to the transfer is required. No formalities apply to such consent, and the consent can also be implied or granted in advance. This form of transfer does not lead to a novation, and as such the same contract continues to be in place between the borrower/guarantor and the transferee.

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, subject to the following exceptions.

As of 1 January 2021, interest paid by Dutch companies (or Dutch branches of non-Dutch companies) is subject to an interest withholding tax if the interest is paid to an entity that is (cumulatively) (i) related to the payer of the interest, and (ii) resident in, or lending through, a low-tax jurisdiction (which includes, amongst others, the United Arab Emirates, Bermuda, the British Virgin Islands and the Cayman Islands) or a jurisdiction that is on the EU list of non-cooperative tax jurisdictions. Two parties are 'related' for these purposes if one party has influence over the activities of the other party (which is in any case assumed to be the case for any shareholders owning at least 50% of statutory voting rights), or if a third person has such influence over both parties. The rate is equal to the highest bracket Dutch corporate income tax rate (21.7% in 2021).

Interest paid on loans with certain hybrid elements (such as subordinate profit-sharing loans that are perpetual or have a maturity of more than 50 years) may be subject to dividend withholding tax (current rate 15%).

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 tax incentives for foreign lenders and no registration taxes or duties (or similar taxes or duties) apply in the Netherlands (irrespective of whether (secured or unsecured) loans are provided by domestic or 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?

No.

If, however, a foreign lender (alone or together with affiliates) (i) owns a direct or indirect 5% equity interest in the borrower (or has the option to acquire such interest), and (ii) holds the equity interest through a legal structure that is considered 'abusive', the income/gains derived by such lender from the debt funding provided to the Dutch borrower may become subject to Dutch corporate 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.?

There are no other significant costs for foreign lenders.

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 a foreign governing law governing contractual obligations will, in principle, be upheld by Dutch courts, on the basis of and subject to, the limitations imposed by Regulation (EC) 593/2008 of 17 June 2008 ('Rome I').

The choice of a foreign governing law governing non-contractual obligations will in principle be upheld by Dutch courts, on the basis of and subject to the limitations imposed by Regulation (EC) 864/2007 of 11 July 2007 ('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?

In the absence of an applicable treaty between New York and the Netherlands, a judgment obtained in the courts of New York will not be directly enforced by the courts in the Netherlands. In order to obtain a judgment which is enforceable in the Netherlands, the claim must be relitigated before a competent court of the Netherlands; the relevant Dutch court has discretion to attach such weight to a judgment of the courts of New York as it deems appropriate. Based on case law, the Dutch courts may be expected to recognise the binding effect of a final, conclusive and enforceable money judgment of a court of competent jurisdiction in New York without re-examination or re-litigation of the substantive matters adjudicated thereby, provided that: (i) the relevant court in New York had jurisdiction in the matter in accordance with standards which are generally accepted internationally; (ii) the proceedings before such court complied with principles of proper procedure; and (iii) such judgment does not conflict with the public policy of the Netherlands.

A judgment obtained in the English courts, provided that such judgement is enforceable in England, is enforceable in the Netherlands (i) if such judgment has been certified as a European enforcement order pursuant to the Council Regulation (EC) No. 805/2004 of 21 April 2004 ('European Enforcement Order'), or (ii) without any declaration of enforceability being required pursuant, and subject, to the limitations and formalities imposed by Council Regulation (EC) No. 1215/2012 of 12 December 2012 (the 'Recast Judgments Regulation'). Both the European Enforcement Order and the Recast Judgments Regulation continue to be applicable during the transition period relating to Brexit, pursuant to the Agreement on the withdrawal of the United Kingdom of Great Britain and Northern Ireland from the European Union and the European Atomic Energy Community dated 24 January 2020.

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?

Court proceedings on the merits take from at least six months up to multiple years before the judgment can be enforced against the assets of the company. It should be noted that the lender may be liable for any damages when enforcing a judgment which is overruled in appeal at a later stage.

If the lender has an urgent interest to enforce against the assets (*spoedeisend belang*), the lender can institute preliminary relief proceedings (*kort geding*). In such proceedings the lender can also ask for provisional measures to be imposed by the court on the company by way of an injunctive relief. Such measures can be executed directly against the company. These proceedings (which usually include a court hearing) take only about two to eight weeks before a judgment is obtained. If successful, the company may appeal or start proceedings on the merits to overrule 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?

Rights of mortgage over property are in principle enforced through a public auction sale under supervision of a civil law notary. Please note that at least one month should have lapsed between the announcement of the public auction and the auction itself. A private sale to a third party is only allowed if the competent court has granted its approval, which takes a couple of weeks to obtain.

Although alternatives are available (e.g. an enforcement agreement with the pledgor), rights of pledge may also be enforced through a public auction sale under supervision of a civil law notary. Also, unless agreed otherwise, an application can be made with the competent court for a different method of sale – such application takes a couple of weeks.

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 principle, no 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?

Under the Dutch Bankruptcy Act, the court may allow a general cooling-off period during a suspension of payments or bankruptcy for a period of up to two months, which can be extended by another two months. During the cooling-off period, the (collateral) security rights of lenders are suspended and cannot be foreclosed without court permission.

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 issued in a dispute with respect to which the relevant parties have validly agreed in writing that it shall be settled by arbitration will be recognised and enforced by the Dutch courts without examination of the merits of the case, pursuant to and subject to the conditions of and limitations of the New York Convention on Recognition and Enforcement of Foreign Arbitral Awards of 10 June 1958 and/or Book IV of the Dutch Civil Procedures Code (*Wetboek van Burgerlijke Rechtsvordering*).

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?

During bankruptcy there is a general moratorium and ordinary and preferential creditors may no longer enforce their claims against the debtor's assets. However, secured creditors are not affected by the moratorium, unless a cooling-off period applies. Please also refer to question 7.6.

The rights of the holder of financial collateral are not affected by insolvency proceedings and it can act as if there were no insolvency proceedings, allowing the security holder to liquidate the assets over which it has security or, if agreed as part of the conditions of the security arrangement, retain ownership of the assets provided as security. Any cooling-off period ordered does not apply to assets subject to a financial collateral arrangement (*financiëlezekerheidsovereenkomst*).

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 bankruptcy, the bankruptcy trustee may challenge voluntary legal acts (i.e. acts where there was no prior legal obligation to perform them) for consideration, and legal acts without consideration that were performed by the debtor. In addition, set-off rights and general preference claims may apply, including from the Dutch tax authorities and from employees (both pre- and post-insolvency), subject to certain conditions.

8.3 Are there any entities that are excluded from bankruptcy proceedings and, if so, what is the applicable legislation?

Although the Dutch Bankruptcy Act does not contain exceptions, it is unlikely that insolvency proceedings could be opened against the Dutch state and local authorities, such as municipalities and provinces.

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?

Unsecured creditors may levy an attachment (*beslag*) on assets of the debtor to ensure that the creditor can take recourse on assets of the debtor if a successful order is awarded. To levy such attachment, the creditor needs prior court approval, which can in general be obtained quite easily, and the attachment is levied by a bailiff, being a government-appointed person.

Also, suppliers may have a retention of title (*eigendomsvoorbehoud*) on assets supplied to a debtor.

Finally, the beneficiary of a non-possessory pledge over moveable assets can see its rights frustrated by means of a seizure by the tax authorities of pledged assets located on the premises of the debtor (*bodemzaken*).

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 Dutch law, the submission by a party to a foreign jurisdiction is binding upon such party. This submission does not preclude that claims for provisional measures in summary proceedings may be brought before a competent court in the Netherlands. Also, we note that certain proceedings are subject to an exclusive jurisdiction (e.g. as regards real estate or consumer contracts).

9.2 Is a party's waiver of sovereign immunity legally binding and enforceable under the laws of your jurisdiction?

From a Dutch law perspective, there is some uncertainty as to whether a person can waive its immunity, to the extent it enjoys immunity. In principle, the State has the sole authority to waive the immunity granted to its nationals.

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 licence requirements apply to foreign lenders solely as a result of offering a loan to Dutch companies (i.e., professionals). Lending to consumers is in principle a licensed activity. An existing (loan) agreement is not void or voidable as a result of a lender not meeting the applicable licence requirements. There are no additional licence requirements for a party acting as agent under a loan (other than those applicable 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?

Under Dutch law, it is prohibited to grant security over assets by means of transferring the ownership of such assets (*fiduciaverbod*).

Compliance with anti-money laundering laws by the parties to a loan agreement is becoming more important. Over the last years, some of the largest banks in the Netherlands have received (criminal) fines for not having an adequate structure in place to detect money laundering.

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1 Overview

1.1 What are the main trends/significant developments in the lending markets in your jurisdiction?

Most notable is the Republic of North Macedonia SME Competitiveness Support Programme.

Loans and grants under the Republic of North Macedonia SME Competitiveness Support Programme are available for **any investment** that helps the company meet the more stringent EU Directives, thereby increasing their market potential and also profitability.

The new credit line provided by the European Bank for Reconstruction and Development (EBRD) via local Partner Banks, together with a 15% grant and free technical assistance funded by the European Union, helps SMEs identify their investment requirements for upgrading to comply with the Priority EU Directives.

1.2 What are some significant lending transactions that have taken place in your jurisdiction in recent years?

Major infrastructure projects are financed through EU funds, the EBRD and the Macedonian Bank for Development and Reconstruction.

North Macedonia becoming a NATO member country in the foreseeable future and the commencement of eventual EU accession negotiations are a major step and hopefully will provide great expectations for a sustainable market economy and a boost to investors' sentiments.

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 one or more other members of its corporate group, taking into consideration the requirements pertaining to major transactions and interested party transactions.

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?

Transactions involving a guaranteeing company that are considered a major transaction shall be subject to approval by the board of directors, the supervisory board and/or the general meeting of shareholders, according to its value. In case a member of the management body or the supervisory body has a personal interest in the realisation of the major transaction, or acts as an interested party in its approval, the requirements pertaining to interested party transactions shall also apply.

It should be noted that each interested party shall be liable to the company, shareholders and other management or supervisory body members for damages caused if, within three years from the day of approval of the transaction with the interested party, the transaction is deemed harmful to the company shareholders or management or supervisory body members that have no interest in the transaction.

2.3 Is lack of corporate power an issue?

As a general rule, if a representative of a company entered into an agreement and acts *ultra vires*, the company shall not be bound by such agreement unless the company subsequently approves it. In case the represented company does not approve it in a reasonable time, the third party may request compensation for damages from the person that acted *ultra vires* if the third party at the moment of conclusion of the contract did not know, nor could have known, that that person did not hold the authority to conclude such contract.

Notwithstanding the aforementioned, any rights acquired by *bona fide* third parties on the basis of a void transaction 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 approvals for major transactions and/or interested party transactions, please refer to question 2.1 above.

There exist special requirements and governmental consents if the Republic of North Macedonia is the guarantor or security provider.

2.5 Are net worth, solvency or similar limitations imposed on the amount of a guarantee?

With respect to solvency, directors may be subject to personal and criminal liability for entering into guarantees/transactions when the company is insolvent or when such guarantees/transactions could render the company insolvent.

2.6 Are there any exchange control or similar obstacles to enforcement of a guarantee?

No, there are not, unless national assets are involved.

3 Collateral Security

3.1 What types of collateral are available to secure lending obligations?

Lending obligations may be secured by pledge over movable property, securities, ownership claims or other rights or mortgage over immovable 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?

This depends on whether the secured asset is different movable property, or a combination of movable and immovable property. However, the agreement should state each type of security and clearly identify each individual asset granted as security.

3.3 Can collateral security be taken over real property (land), plant, machinery and equipment? Briefly, what is the procedure?

The pledge over plant, machinery and equipment can be acquired as possessory or non-possessory.

The right of non-possessory pledge is established by signing a written pledge contract, submitting the inventory and a description of the subject of the pledge and registering it in the Pledge Register.

The right of possessory pledge is established by signing a pledge contract (a written form is recommended, but not obligatory) and transferring the subject of the pledge into the possession of the pledgee.

The right of mortgage over real property can only be established as non-possessory. Hence, the lender and the security provider shall enter into a written pledge agreement, then certify it as a deed before a notary public and register the mortgage over real property in the Agency for Real Estate Cadastre.

3.4 Can collateral security be taken over receivables? Briefly, what is the procedure? Are debtors required to be notified of the security?

A pledge may be established over receivables and is perfected upon registration in the Pledge Registry. Notification of debtors is a condition that must be met in order for the pledge to be valid.

3.5 Can collateral security be taken over cash deposited in bank accounts? Briefly, what is the procedure?

Cash deposited into bank accounts may be pledged and is perfected upon registration in the Pledge Registry only up to the amount identified at the time of the establishment of the security.

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 structure of the company.

Pursuant to Macedonian jurisdiction, both stocks and shares are not in certificated form.

Hence, all stocks issued in the Republic of North Macedonia shall be registered within a Central Securities Depository as electronic records.

Share certificates shall be issued in the form of a transcript of the data registered in the company's register of shares, but it should be noted that a share certificate issued to a member of a company shall not be considered as a security.

Such security cannot be granted under a New York- or English law-governed document.

3.7 Can security be taken over inventory? Briefly, what is the procedure?

A pledge may be established over inventory as possessory or non-possessory.

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 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-mentioned collaterals.

The resident company may also guarantee borrowings of non-residents and therefore provide all collaterals listed above, unless the National Bank 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?

Notarisation fees depend on the value of the secured receivable, but they cannot be more than EUR 1,000.

The registration fees differ if the secured asset is a pledge or mortgage. The fees related to registration of the pledge at the Pledge Register are about EUR 12 (for fewer than 30 pledged assets) or about EUR 18 (if there are more than 30 pledged assets). The fees related to registration of the mortgage with the Agency of Real Estate Cadastre may amount to EUR 2,000.

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?

The deadlines for security registration are prescribed by law.

The registration application for registering the mortgage is filed electronically by the notary public who certified the pledge agreement and the Agency of Real Estate Cadastre shall register the mortgage within three days.

Regarding movable property, the registration application may also be submitted electronically to the Pledge Register and the pledge shall be registered within 15 days of the submission of the registration application.

3.11 Are any regulatory or similar consents required with respect to the creation of security?

No, unless the Republic of North Macedonia is the security provider.

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 relating to such matter.

3.13 Are there particular documentary or execution requirements (notarisation, execution under power of attorney, counterparts, deeds)?

Other particular documents may be required on a case-by-case basis.

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
Regarding joint-stock companies, transactions in which the company provides a third party with any type of financial assistance, for the purpose of acquiring shares in that company, shall be considered null and void. This does not apply to the normal legal transactions of banks and other financial institutions and/or when the company acquires treasury shares for the purpose of their distribution to employees under the procedure prescribed by law.

(b) Shares of any company which directly or indirectly owns shares in the company
Transactions between joint-stock companies and third parties that authorise and/or oblige the third party to acquire shares in another company on behalf of the company, a controlled company and/or a company in which the company has a majority share, shall be considered null and void.
The company may acquire its own shares via repurchase, either itself and/or through a third party acting in his/its name but on behalf of the company, under conditions prescribed by law.

(c) Shares in a sister subsidiary
The aforementioned provision on invalidity transaction shall also apply to financial assistance for 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 Macedonian jurisdiction does not recognise the concept of agency or security 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?

The lenders may enter into an agreement whereby one of the lenders may be appointed to act as a facility agent and he/she may enforce rights on behalf of the lenders if he/she has been duly authorised to do so.

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 contract of assignment shall have no effect for a debtor party unless the debtor party and the creditor party have agreed that the latter shall not be able to assign the claim to another, or that it shall not be able to assign it without consent from the debtor party.

Even though the debtor's consent is not always necessary for an assignment, the lender is obliged to notify the debtor of the effected assignment.

It shall be noted that the assignee and the third party shall register the assignment with the relevant public registries.

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 paid to a foreign legal entity (resident or non-resident, whereby the resident has a permanent business unit in the Republic of North Macedonia if the interest is at the burden of the permanent business unit) is subject to withholding tax, unless otherwise provided by any international treaties for prevention of double taxation.
The taxpayer shall be the borrower (a domestic legal entity; a domestic natural person – registered to perform activity and a foreign legal entity; or natural person – a non-resident with a permanent business unit in the Republic

of Macedonia), who is obliged to retain and pay tax on income and deposit it in the respective deposit account at the same time as the income.

If the recipient of the income for which the tax retention is applied is a resident of a foreign country which has an agreement with the Republic of North Macedonia for double taxation prevention regarding the taxes for revenue and capital, then the tax rate determined for that income must not exceed the tax rate applied for the income, which is determined in the agreement.

Notwithstanding the above, the tax shall not be retained for income from interest from debt instruments issued and/or guaranteed by the Government of the Republic of North Macedonia, the National Bank of the Republic of North Macedonia and banks or other financial institutions that act as representatives of the Government of the Republic of North Macedonia.

(b) There are no special requirements to deduct or withhold tax from 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 for 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?

The income of the foreign lender will not become taxable solely on the ground of granting a loan, guarantee, or security.

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 should not be any costs other than the aforementioned.

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 not be any adverse consequences solely because of the fact that the lender is organised under the laws of a jurisdiction other than North Macedonia.

A proportional part of the interest related to a loan received from a non-resident shareholder, who directly holds at least 20% of the capital in the company that exceeds three times its share in the equity in the company, will be taxable during a tax period. Thin capitalisation rules also apply to loans from banks if they are granted in relation to a deposit of the shareholder in that particular bank.

Note that thin capitalisation rules do not apply for newly established entities within the first three years of operation, including the year of establishment.

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 Macedonian Courts recognise a foreign governing law in contracts if there is a foreign element. However, the parties cannot avoid the application of *jus cogens* provisions of the Macedonian 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.

The enforcement of a judgment is conducted through enforcement agents. In order for the judgment to be enforceable, it shall first be recognised by the Macedonian Courts and therefore the following conditions have to be met:

- the foreign judgment shall be effective and enforceable according to the law of the State in which the judgment was rendered;
- the case should not be in the exclusive jurisdiction of Macedonian Courts;
- it is not a matter of *res judicata* and no litigation has already been initiated before the Macedonian Courts for the same legal matter and between the same parties; and
- the recognition does not violate the Macedonian public order.

Notwithstanding the above, the Macedonian Court shall not recognise a foreign judgment if one of the parties proves that it has not been granted the right 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?

The timeline depends on the complexity of the case, but in general it takes one to three years to obtain a final and non-appealable judgment.

The duration of the procedure of recognising a foreign judgment is also on a case-by-case basis and it may take more than one year.

The enforcement procedure depends on the liquidity and 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?

Significant restrictions that may impact the timing and value of enforcement include public mandatory auctions (up to three public auctions for immovable property and up to two auctions for movable property).

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?

When a foreign lender files a suit, upon the defendant's request, the foreign lender will be obliged to provide the litigation expenses as a security deposit (*cautio iudicatum solvi*).

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 official opening of a bankruptcy procedure includes a general moratorium for all creditors and it prevents the initiation or suspends the continuance of any court, administrative or other individual actions related to the property, rights, obligations and responsibilities of the 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?

North Macedonia 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, subject to certain conditions.

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 creditors are entitled to right of separate settlement over the collateral security, which is recorded in the public books.

Once the bankruptcy procedure has commenced, the secured creditors shall submit the bankruptcy claim to the bankruptcy trustee, who is obliged to prepare a charter of the secured creditor's claims (list of adopted and disputed claims), to deliver the charter to those creditors whose claim is disputed, as they are entitled to an appeal right, and also to deliver it to the bankruptcy judge at the Court.

At the first hearing (meeting of the creditors), the bankruptcy trustee shall state which complaints shall be allowed and which of them shall be rejected. The judge, within three days of the conclusion of that hearing, shall render a decision which shall state the adopted and the disputed claims (including the exact amount of any claim). By virtue of the court decision, the secured creditor may initiate an enforcement procedure.

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 trustee of the company as well as the creditors may contest the company's transactions that were done to the detriment of the creditors in a limited period of time, prior to the commencement of the bankruptcy procedure.

8.3 Are there any entities that are excluded from bankruptcy proceedings and, if so, what is the applicable legislation?

A bankruptcy procedure may not be conducted over the property of the Republic of North Macedonia, as well as over other legal entities with public authorisations. Also, banks are subject to different conditions when commencing a bankruptcy 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?

Once the bankruptcy proceeding starts, there are no other means to 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?

Yes, provided no national assets are involved.

9.2 Is a party's waiver of sovereign immunity legally binding and enforceable under the laws of your jurisdiction?

Yes, provided no national assets are 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 is performed by banks, which must have a special licence to operate as a bank from the Macedonian National Bank.

Also, the activity of granting credits can be performed by financial companies, which must have a prior licence for establishment and operation from the Ministry of Finance.

There are no special licensing requirements for foreign legal and natural persons to give loans, provided that the financing activity is not performed on a regular basis.

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?

Whether there are any other material considerations is on a case-by-case basis.

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TRPENOSKI
ATTORNEYS AT LAW

Portugal

PLMJ Advogados, SP RL

Gonçalo dos Reis Martins

1 Overview

1.1 What are the main trends/significant developments in the lending markets in your jurisdiction?

The Portuguese economy continues to grow at a stable pace of 2% per annum. Lending markets have played an important role in allowing the economy to grow.

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 2019 have included vendor financing transactions in relation to disposals of NPL portfolios by Portuguese banks, real estate financing transactions and M&A-related finance.

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 benefitting 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, 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 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 the 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 on 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 those 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 (*princípio 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 award 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 creditors' 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 the answers above fairly address the main material issues that arise generally in the context of lending transactions.

Gonçalo dos Reis Martins has gained 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 offered 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 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 lectures. 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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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 and EU sanctions in recent years. The major deals involving state-owned banks and companies have been non-public and 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, aluminium, gas, gold, fluorspar, magnesia and other commodities which demonstrate the recent market trend of prepayment structures expanding well beyond the oil market. In view of the growing trade between Russia and Asia, the prepayment finance market is also expanding to Asia.

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, although 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 2019, the liberalisation of the currency control regulations continued. One of the significant changes was the gradual abolishment of the repatriation requirements for ruble earnings under foreign trade agreements between residents and non-residents.

The launch of the Project Finance Factory (a project finance mechanism for investment projects in Russia's priority industries) administered by VEB.RF, a Russian state corporation, led to increased popularity of project financing in Russia. In order to qualify for financing by the Project Finance Factory, a project should comply with the following criteria: (1) the project value shall not be less than RUB 3 billion; (2) the tenor shall not exceed 20 years; and (3) the sponsor's equity investment shall not be less than 20%.

1.2 What are some significant lending transactions that have taken place in your jurisdiction in recent years?

Significant public finance transactions in 2018–2019 include, among others:

- a EUR 11.4 billion project financing for the construction of the Amur Gas Processing Plant by 22 banks from Europe, Asia and Russia, including the China Development Bank, Gazprombank, Sberbank of Russia and VEB.RF;
- a USD 2 billion syndicated financing of Baikal Mining Company by Sberbank of Russia, Gazprombank and VEB.RF;
- a RUB 6.3 billion financing of PJSC KuibyshevAzot by VEB.RF and Gazprombank;
- a USD 1.055 billion five-year pre-export financing of SUEK arranged by a group of 18 international and domestic lenders;
- a USD 725 million and EUR 650 million dual-currency 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;
- an approximately USD 907 million (EUR 720 million and USD 120 million) dual-currency loan refinancing of Siberian Anthracite with Commerzbank, Credit Suisse, ING, Industrial & Commercial Bank of China, Intesa Sanpaolo, Sberbank, Société Générale and UniCredit as the mandated lead arrangers;
- a USD 300 million syndicated loan to refinance Eurobonds for Nordgold arranged by ING, Raiffeisenbank, Raiffeisenbank Bank International, Rosbank, Société Générale and UniCredit;
- a USD 250 million syndicated pre-export financing 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 Société Générale.

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" (i.e., a transaction amounting to 25% or more of the company's assets) or an "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 a 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 transaction. 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" 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. A company issuing a guarantee has an obligation to publish this fact and the material terms of a guarantee in the Uniform State Register of Information on the Activity of Legal Entities (*Fedresurs*) (for more information, please refer to question 3.9).

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 or, in other cases, is 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 a 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 a pledge of immovable property (mortgage), pledge of equipment (or other movable property), 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 a pledge to "all assets" of a 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 (for more information, please refer to question 3.9).

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. The 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 a 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 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 take 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 take 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, participatory interests, trade marks, patents, 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.

A company issuing a guarantee or proving pledge over its movable assets must record this fact and the material terms of a guarantee (pledge agreement) in the Uniform State Register of Information on the Activity of Legal Entities (*Fedresurs*). Failure to publish such information does not affect the validity of a guarantee but constitutes an administrative offence. From 1 April 2020, the creditors will also be entitled (but not obliged) to publish the same information about suretyships provided to them.

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 it 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 five to 10 days. Foreign pledgors and pledgees must collect and submit to the notary a set of notarised and apostilled corporate and other documents, which often take some additional time.

Notices regarding pledges of movable property are submitted by the notaries and can be done within one or two 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. A conservative interpretation of antimonopoly and foreign investments laws may purport to treat the security arrangement itself or certain covenants within it as the creditor obtaining "control" over the relevant debtor. However, as a matter of market practice, no consents of antimonopoly or other authorities are usually obtained with respect to the creation of security; depending on the situation, the creditors may consider applying for an antimonopoly clearance or at least for official guidelines at the enforcement stage.

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) such as those 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 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. The Russian Civil Code 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, VEB.RF, 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, including in actions such as collecting funds under the 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 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 its 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 a 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.

In accordance with recent changes to the Tax Code, a borrower is not required to obtain a tax certificate from a foreign lender in order to apply the relevant international tax treaty if the tax residency of such lender can be verified via reliable public sources (e.g., the lender is included in the Banker's Almanac or the International Bank Identifier Code Directory).

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 (i) there is a "foreign element" in the transaction (e.g., one of the parties is a foreign entity or the subject matter of the contract relates to foreign assets), and (ii) 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.

If there is no "foreign element" in the transaction, the parties can still choose foreign governing law, but the Russian courts would then not apply such foreign law to the extent that it contradicts mandatory provisions of Russian law (which are rather extensive).

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, 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, 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 judgment.

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. The creditor would also be able to select an out-of-court enforcement when it has actual possession over the pledged assets (e.g., the lender also acts as a depositary for the shares pledged to it or as the account bank where the rights under such bank account are pledged to it).

Out-of-court enforcement may be exercised by the following methods: 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 and participatory interests 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 written 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 the introduction of the supervision procedure (the 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 a 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" may be contested in the course of insolvency.

"Suspicious" transactions are those entered into (1) with the intention to infringe creditors' rights within the three-year period preceding the commencement of the insolvency proceedings, or (2) at an undervalue within one year 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 jurisdiction of a foreign court 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 foreign account with a bank located in: (1) the Eurasian Economic Union; (2) a foreign state which participates in the automatic exchange of financial information with the Russian Federation under the Multilateral Agreement on Automatic Exchange of Financial Information dated 29 October 2014 (the Multilateral Agreement); or (3) a foreign state which is a party to any other international treaty stipulating for automatic exchange of financial information with the Russian Federation, provided that: (i) a lender is (a) an agent of a foreign government, (b) located in the Eurasian Economic Union, (c) located in a foreign state which participates in the Mutual Agreement, or (d) located in a foreign state which is a party to any other international treaty stipulating for automatic exchange of financial information with the Russian Federation; and (ii) 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?

The banking system in Singapore remained healthy in 2019 with ample capital reserves and overall liquidity positions remaining strong against a backdrop of rising uncertainty in the macro-economic landscape from events such as, *inter alia*, the United Kingdom's withdrawal from the European Union, the ongoing trade and geopolitical tensions between the US and China and most recently, the COVID-19 outbreak which was declared by the World Health Organisation as a Public Health Emergency of International Concern.

The Monetary Authority of Singapore (***MAS***) reported that credit growth in Singapore has moderated in 2019, while overall asset quality has slipped slightly from 2018, particularly for trade-related sectors. The Ministry of Trade and Industry Singapore has further reported in February 2020 that the COVID-19 outbreak is likely to dampen growth prospects in China and other affected countries this year, which will in turn have a rippling effect on regional economies, including Singapore. Indeed, the Singapore banks have begun to observe a contraction in consumer loan growth and have flagged risks to earning as a result of the outbreak.

Nevertheless, the MAS' annual industry-wide stress test results reveal that banks in Singapore continue to possess sufficient capital and liquidity buffers to withstand severe shocks, and Singapore Dollar funding remains adequate as deposits continue to exceed loans. The MAS has also 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, there have been notable advances in improving the position of Singapore's banking system in the fields of (1) digital banking and (2) sustainable financing. To further liberalise and diversify Singapore's banking system, the MAS has decided to issue up to five new digital bank licences to maintain the competitiveness and robustness of Singapore's banking sector in the digital economy of the future.

2019 also saw the MAS unveil its green finance action plan to improve local green financing capabilities including the launch of Singapore's first US$2 billion Green Investments Programme, which seeks to bolster the market for green finance activities in Singapore, in line with embracing the global trend of "Green Finance".

1.2 What are some significant lending transactions that have taken place in your jurisdiction in recent years?

Singapore's increasing support of sustainable financing in 2019 has translated into a number of significant green loan transactions, including a S$670 million club loan to Mapletree Commercial Trust, a Singapore-focused real estate investment trust which is listed on the Singapore Exchange Securities Trading Limited, to partially finance its acquisition of "Mapletree Business City Phase 2", a certified BCA Green Mark Platinum property designed with environmentally friendly features. The team of lenders consisted of DBS Bank and OCBC Bank (acting also as green loan coordinators) as well as the Singapore branches of the Bank of China, Citibank and Sumitomo Mitsui Banking Corporation. In its bid to promote sustainability as a core value of its business, the Mapletree Commercial Trust has established a green loan framework, guided by the Green Loan Principles from the Loan Market Association and the Asia Pacific Loan Market Association, to outline criteria for using the green loan proceeds.

Another green finance deal that took place in 2019 is the S$332.5 million club loan to Ophir-Rochor Hotel Pte Ltd, a subsidiary of Singapore property developer Hoi Hup Realty Pte Ltd, marking the Hoi Hup group's maiden green loan. The green loan proceeds are to partially finance the acquisition of Andaz Hotel in Singapore, which has been certified and awarded for having environmentally friendly features such as efficient energy and water usage. The loan, which according to a joint statement from the Hoi Hup group and OCBC Bank is the first green loan for Southeast Asia's hospitality industry, was provided by OCBC Bank (acting also as the green loan adviser) as well as Maybank Singapore and United Overseas Bank.

Some further sustainability-linked loans which OCBC Bank had participated in include large syndicated loans such as Cofco International's US$2.3 billion senior unsecured facilities, as well as Dreyfus Company Asia's US$650 million revolving credit 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, 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 from such prohibition. 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 a 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?

Land

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.

Machinery and equipment

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. An express written notice of assignment must also be given to the account bank to perfect the security and preserve priority. 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 Securities Trading 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 if it falls under one of the prescribed categories of s131 of the CA. In the case of a statutory charge over shares in scripless form, an express written notice of assignment must also be given to the depository agent to perfect the security and preserve priority. 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/s163 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 up 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 or even several months 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 the intention of the settlor to create the trust, the identity of the subject matter and the 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 tax 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 either (i) borne, directly or indirectly, by a person resident in Singapore or a permanent establishment in Singapore (except in respect of any business carried on outside Singapore through a permanent establishment outside Singapore or any immovable property situated outside Singapore), or (ii) 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 (assuming the payment is not derived by the non-resident from any trade, business, profession or vocation carried on or exercised by him in Singapore and is not effectively connected with any permanent establishment in Singapore of the non-resident).

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, where the guarantee is provided for or on behalf of a person resident in Singapore or a permanent establishment in Singapore.

For the purposes of s12(6A), a qualifying "non-resident" is a person who is not incorporated, formed or registered in Singapore and 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 through, or effectively connected with, 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 a country with which Singapore has an applicable tax treaty, the treaty may provide for a 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. 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 are not affected by the residency of the investors or creditors, there are selected schemes directed at attracting foreign investors and creditors. For example, interest payments on approved loans taken to purchase productive equipment for the purposes of trade or business may enjoy an exemption from withholding tax or a reduction of the withholding tax rate.

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 either (i) borne, directly or indirectly, by a person resident in Singapore or a permanent establishment in Singapore (except in respect of any business carried on outside Singapore through a permanent establishment outside Singapore or any immovable property situated outside Singapore), or (ii) 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% (and will be raised to 9% by 2025).

6.5 Are there any adverse consequences to 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.

Singapore tax laws do not contain thin capitalisation rules. However, 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 governing the finance documents may be that of the foreign jurisdiction. In such a situation, the borrower may not be able to enjoy any rights and remedies which are 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, which 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 four years since 2015, the SICC heard a number of cases on a range of subjects and involving parties from various jurisdictions. Additionally, the Supreme Court of Judicature (Amendment) Act 2018 clarified that the SICC has jurisdiction to hear any cases relating to international commercial arbitration.

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. Apart from Singapore, these states currently comprise all of the EU Member States (and, at least for the post-Brexit transition period running from 31 January 2020 to 31 December 2020, England), Montenegro and Mexico. The United States of America, People's Republic of China, Republic of North Macedonia 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, 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, although such orders are rarely made. For the moratorium to have extraterritorial effect, the debtor must seek to restrain a specific act or acts of a specific party who is in Singapore or within the jurisdiction of the Singapore Court. The Singapore Court will not grant a general worldwide or extraterritorial moratorium over unspecified acts or parties which are not subject to its jurisdiction.

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; the subject-matter of the difference between the parties to the award not being 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, unfair 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 (unfair 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.

For corporations convicted of unlicensed moneylending, a fine will be imposed 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?

Following the setback during the economic and financial crisis, the economic situation in Slovenia continued to improve in 2019. The value of the composite Economic Sentiment Indicator almost reached pre-2008 levels. The economic forecast for Slovenia is also optimistic. In November 2019, the European Commission forecasted that GDP growth in 2020 in Slovenia will be 2.7%.

Loans to domestic non-banking sectors in Slovenia continued to strengthen in 2018 and will do so for at least a year. Consumer credit growth was particularly high in 2018; however, consumers are exposed to much higher interest rates as with other forms of lending. Furthermore, the volume of corporate and NFI loans increased after a year of gradual falling but still remains relatively low. The increase of corporate and NFI loans is especially a consequence of lower corporate deleveraging. Growth in the volume of bank loans thus remains moderate.

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 a 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 an insolvency proceeding is initiated against the debtor; and
- conditions for challenging 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 the 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:

Security over real estate (mortgages). 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.

Non-possessory pledges. A registration fee of up to EUR 50 applies.

Security over shares in LLC. 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.

Security over intellectual property. 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

LLCs. 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.

Corporations. 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) No 593/2008 on the Law applicable to Contractual Obligations (Rome I Regulation), which accordingly also governs the choice of law rules. Subject to the limitations set forth in the 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 enforcement, under Article 39 of the 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 the 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 for 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 an 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 the 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 at the time of enforcement: *inter alia*, certain public bodies, central banks, credit institutions, etc., while the debtor (pledgor) 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 sale is presumed under the law.

Enforcement on receivables. Both in-court and out-of-court enforcement is possible.

For 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 pay, 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 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 have also made steps to serve our clients via automated processes, responding to market demands with ground-breaking approaches.

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South Africa

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1 Overview

1.1 What are the main trends/significant developments in the lending markets in your jurisdiction?

Debt restructurings and unsecured lending have been on the rise as a result of continued economic pressures. Policy proposals to permit expropriation of land without compensation, together with otherwise policy inertia and uncertainty, continue to constrain investment and confidence in the South African economy.

The stabilisation and reform of state-owned entities has become critical and will likely lead the South African Government's agenda and efforts over the next few years. A number of state-owned entities mired in financial and governance crisis have commenced restructuring processes in an attempt to restore financial and operational sustainability.

1.2 What are some significant lending transactions that have taken place in your jurisdiction in recent years?

- Arguably the most high-profile restructuring over the last year which will continue into 2020 is that of South Africa's national carrier, South African Airways (SAA). SAA was placed in business rescue in December 2019 and was provided ZAR2 billion in post-commencement financing by local commercial banks as the first step in its restructuring.
- PepsiCo, Inc acquired South Africa's Pioneer Foods through PepsiCo's existing South African subsidiary, Simba, for approximately ZAR24.4 billion. The acquisition price was partly funded by The Standard Bank of South Africa which is understood to be the largest ever cheque to be written by a South African bank at one time.

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 acknowledgment 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 reasonable 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 a 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 notaries public 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 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 as the granting of security or a guarantee by the South African resident in favour of a 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 Civil 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 Nations Commission on International Trade Law, has been wholly adopted into South African law for the purposes of international arbitral awards. In effect, as regards 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 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's and master's 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 which 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 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 a 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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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 above the euro area average. 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. In this sense, forecasts still place Spain among the leading growing economies in the European Union with 1.6% expected growth.

Although bank financing will continue to be the main source of financing, businesses and individuals are turning their eyes more recurrently to non-traditional sources of funding.

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 2019 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.

A significant trend that is worth flagging involves the notorious increase of financing linked to sustainability criteria, such as green loans. European markets currently lead global sustainability-linked loan volumes, with a share of more than 80% of the market. Activity has focused mostly on Spain, France and Italy. The most prominent Spanish banks are significantly taking into account the impact of their activity on the environment when conducting their credit assessment and this is a trend we definitely expect to consolidate in the upcoming years.

Finally and regarding the real estate market, a recently enacted law (Law 5/2019, regulating real estate credit agreements) may impact on household financing. This law seeks to establish imperative rules for the protection of natural persons, regardless of whether or not they are consumers, who hold the position of borrowers, guarantors or holders of guarantees in loans or credits granted by means of a mortgage or another security right on real estate for residential use.

1.2 What are some significant lending transactions that have taken place in your jurisdiction in recent years?

2019 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 Abengoa refinancing (€3 billion), Corte Inglés (€2 billion), Europastry (€750 million), Sando (€600 million), Inspired Group (€540 million), Dragados (€463 million), Grupo Levantina (€415 million) and Cementos Molins (€180 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: on a master loan agreement to finance VGP logistics centers (€800 million); on the acquisition finance to buy 85% of Autopista del Sol (AUSOL) (€586 million); to Forestalia on financing 10 project wind farms (Project Phoenix, 324 MW) (€400 million); on refinancing the Geredìaga-Elorrio highway (€268 million); to Renomar on the refinancing of several wind farms (€235 million); and to Metric Capital Partners on financing certain luxury hotel premises (€170 million).

And, in Latin America, we note our advice: to extend the financing of the 84 MW Tizimín wind farm in Mexico ($119 million); on the project financing to build two 82.5 MW and 34.2 MW photovoltaic power plants in Mexico ($84 million); as well as the financing of the 4G project in Colombia and a hydrocarbon storage terminal developed by CLH in Mexico.

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 Project Makalu, March, Chicago, Sound and Niseko (Hokkaido, Sapporo, Carport/Sagunto), clearly showing the Spanish bank's interest in cleaning up its 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 to 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.

The existence of a detriment to the estate of the guaranteeing company can be challenged by evidencing that there is a regular trend of providing borrowing and guarantees among companies belonging to the same group or by attesting that the guarantee entailed some economic advantage to the guarantor.

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*) or sureties (*avales*).

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. The collateral value of the *in rem* security is linked to the value of the underlying secured asset, while the value of the personal guarantees relies on the estate of the guarantor considered as a whole. 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 and convey it on the relevant deed by means of which the mortgage is formalised, 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. Registration within the Property Registry is mandatory for mortgages; the mortgage does not formally exist until it is entered in the Property Registry.

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, it is required that the debtor be notified of the granting of the pledge. Once notice has been received by the assigned debtor, any payment made by the assigned debtor to the assignor instead of the assignee will not release the assigned debtor.

The non-possessory pledge (*prenda sin desplazamiento de la posesión*) does not require notification to the relevant debtor, since 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, which allows them to appropriate directly (without following court or out-of-court enforcement proceedings) the credit rights in case of default; however, only certain parties (namely, credit institutions) can benefit from such special regime.

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 the 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 to be perfected. 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 and also the identification of the premises where such inventory will be located throughout the life of the pledge.

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 2% 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. This timeframe is not mandatory by law and therefore largely depends on the public registry and the amount of work of such registry. Nevertheless, on occasions 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, 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 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 (with certain exceptions, such as those for listed companies or certain financial institutions). In particular, individuals executing a public deed before a notary 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 2020. 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 0% and 15%) provided that the foreign treaty lender is the "beneficial owner" of the interest. 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) provided that the EU lender is the "beneficial owner" of the interest (please refer to the recent ECJ judgments, of February 26th, 2019, on the Danish cases and their impact on the concept of "beneficial ownership", as they provide guidance on the interpretation of this concept).

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 (under Section 42 of the Spanish Commercial Code) indebtedness are not tax-deductible if the funds are used to make capital contributions to other corporate group entities, or to acquire from other corporate 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.

Additionally, interest paid for leveraged buy-out share acquisitions, where within four years following the acquisition, the acquired entity is included in the tax group of the acquirer or is merged with acquirer, 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 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 interest paid is not taxed – or taxed at a nominal tax rate lower than 10% – because of a different characterisation of the financial instrument under local regulations (e.g. when those interest 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?

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.

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 investors 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?

In general terms, lending or the granting of a security by a foreign lender to a Spanish company would not create a taxable presence (i.e. a permanent establishment) in Spain to a foreign lender.

Under current Spanish Corporate Income Tax regulations, interest 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 provided that they are the "beneficial owners" of the interest (the "beneficial ownership" concept should be analysed in light of the criteria provided by the recent ECJ judgments on the Danish cases).

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 of the lender. Exceptionally, adverse tax consequences (documentation obligations and other anti-abuse measures) might arise when the 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 – at least until the transition period of Brexit comes to an end – 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); and

(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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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. Debt funds have also entered the market, primarily in the leveraged finance area.

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. In some situations, all shareholders may need to approve the transaction. 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 formally required for granting guarantees and security interests, but may sometimes be advisable.

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*). An alternative way to take security over movable goods is instead to issue a floating charge as further described in 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?

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. An alternative way to take security over receivables is instead to issue a floating charge as further described in question 3.2 above.

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 types of arrangements stand the risk of clawback during certain hardening periods in case the security provider subsequently enters into bankruptcy proceedings. If the account bank is also the lender, then the right to set-off in insolvency may mitigate the clawback risk.

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. Finally, the financial assistance prohibition may be restricted to acquisition of parent entities within the same Swedish group, so each situation needs to be carefully analysed.

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. As it is uncertain if foreign law trusts would be recognised under Swedish law, it is advisable that such representatives are also appointed to act as agents.

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?

The main principle is that Swedish law neither contains any obligation to withhold tax as regards interest payable on loans made to a domestic lender or foreign lender, nor any withholding 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). A Swedish court may enforce foreign law contracts if it has jurisdiction.

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.

Subject to the changes effected by Brexit, any transition period under any withdrawal agreement and any future changes to the regimes, 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 the 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 the 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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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.

On 1 January 2020, the Financial Services Act (FinSA) and the Financial Institutions Act (FinIA), together with their implementing ordinances, have entered into force. The FinSA contains rules for offering financial services and distributing financial instruments. The FinIA essentially harmonises the authorisation rules and organisational requirements for financial institutions.

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 those 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 7.7%. 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. As of 1 January 2020, the Financial Services Act (FinSA) regulates the offering securities and other financial instruments, as well as the provision of financial services, subjecting financial service providers to certain prerequisites. Under the FinSA, lending activities are, in principle, not considered financial services and consequently do not fall within the scope of the FinSA. However, the granting of loans to finance transactions with financial instruments is considered a financial service subject to specific requirements such as, *inter alia*, client segmentation, training, organisation and documentation 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?

No, there are not.

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1 Overview

1.1 What are the main trends/significant developments in the lending markets in your jurisdiction?

The impact of the U.S.-China trade war and the stagnation of economic growth in China extended from 2018 into 2019. According to a news report, the total amount of syndicated loans dropped to US$33.1 billion in 2019 in Taiwan, an 8% decrease compared to 2018. Such decrease is mainly due to the rise of lending transactions among individual banks and the use of locally issued bonds instead of syndicated loans.

Taking advantage of the U.S.-China trade war, the Taiwanese government implemented a three-year Action Plan for Welcoming Overseas Taiwanese Businesses to Return to Invest in Taiwan (the "Action Plan"), an incentive scheme for Taiwanese business located abroad to return to and invest in Taiwan. The Action Plan offers customised single-window service and implements five main strategies (including land acquisition, human resources, access to financing with a NT$500 billion loan subsidy for processing fee payable by corporate borrowers, stable water and electricity supplies, and tax services). Total investments of around NT$716 billion have been pledged by Taiwanese business operating in China under the Action Plan as of February 2020. As the investment activities are expected to increase in 2020, the lending market is expected to see positive prospects in 2020.

Loan demand from wind-power projects continue to provide support for the loan market in Taiwan. The Taiwanese government approved the Special Act for Forward-Looking Infrastructure in July 2017. Against this backdrop, the government investment in large-scale infrastructure programmes (including railways, aquatic environments, green energy, digital technology, and urban and rural facilities) will total NT$882.49 billion (equivalent to around US$28.56 billion), and is expected to spur public and private investment to reach NT$1.78 trillion (equivalent to around 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. Key syndicated loan offshore wind projects in 2019 include a NT$74.2 billion loan by WPD, a NT$25 billion loan by Ørsted and a NT$62.4 billion loan by Formosa 2. A NT$80 billion loan by Copenhagen Infrastructure Partners (CIP) is likely to be closed in early 2020. In addition, there are also many syndicated or bilateral loans made for the solar energy projects.

1.2 What are some significant lending transactions that have taken place in your jurisdiction in recent years?

(1) In January 2019, Winbond Electronics Corporation secured a syndicated loan of NT$42 billion (US$1.4 billion) with a banking consortium comprising 19 banks. According to local news, the syndicated loan closed 193% oversubscribed. The loan is to be used for construction of its 12-inch wafer fabrication plant in Kaohsiung, Taiwan and purchase of the machinery and equipment.

(2) In May 2019, WPD secured a syndicated loan of NT$74.2 billion (US$2.48 billion) from a consortium of 19 banks (including four local banks and 15 foreign banks). The loan is to be used for construction of WPD's Yunlin Offshore Wind Farm.

(3) In June 2019, Ørsted secured a syndicated loan for NT$25 billion (US$830 million) with 15 domestic and foreign banks including eight government-backed banks. The loan is to be used for development and construction of the Greater Changhua offshore wind projects.

(4) In October 2019, Lihpao (Shanghai) Real Estate Development Co., Ltd. signed a syndicated loan for RMB2.6 billion (US$370 million) with 10 banks led by Mega International Commercial Bank. The loan is to be used for development and construction of the Hongqiao Lihpao Plaza in Shanghai, China.

(5) In October 2019, Formosa 2 Wind Power Co., Ltd. secured a NT$62.4 billion (US$2.08 billion) syndicated loan from 20 banks. Formosa 2 Offshore Wind Farm was owned by a joint venture between Macquarie Capital and Swancor Renewable Energy. The loan is to be used for development and construction of the offshore windfarm owned by Formosa 2.

(6) In December 2019, Nan Rong Development and Construction Co., Ltd., Yuan Ruei Development Enterprises Co., Ltd., and Jhih Kai Development Co. Ltd. co-signed a syndicated loan agreement in the amount of NT$30 billion (equivalent to around US$1 billion) with a banking consortium led by Hua Nan Commercial Bank. The loan is to be used for construction and development of the Nan Gang World Pearl Development Project, which includes two business buildings and six residential buildings.

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 the prior approval of the Investment Commission ("IC") of 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 plant, 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 in 2018, 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, as of now, in practice, a foreign company without a branch in Taiwan still has to register and have a branch in Taiwan in order to obtain a chattel mortgage.

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 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, Eswatini, 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 a 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 (only in relation to the real estate mortgage) 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 a 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 special licensing and other eligibility requirements in Taiwan for an agent under a syndicated facility to lend to a company in Taiwan. However, in practice, an agent is normally a member of the syndication and the creditor's 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. Given that a foreign bank does not have a banking license in Taiwan, whether a foreign bank which acts as a facility agent and carries out payment/repayment matters would be deemed to "handle remittance of funds" under Article 29 of the Banking Act, an activity exclusively reserved for banks, is still subject to the views of the Taiwanese banking regulators or the test of Taiwan courts.

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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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 showed signs of strength in 2019, with the annual value of loans increasing by an average of 4.44% per month (for January to November). Annual loan growth in July 2019 was 5.1% (the highest rate for any month in the year) compared to 3.2% in July 2018. 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 2019 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 profits in the first nine months of 2019 by 13.6%, 42.6% and 5.6% 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, 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 that are investing in various types of real estate, such as 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.

The UAE experienced modest economic growth, with the UAE Central Bank estimating annual overall GDP growth to be 2.3% for 2019. This compares to 1.7% for 2018, yet was still below the figure of 3.5% that was previously projected by the UAE Central Bank at the end of 2018. UAE banks remain well capitalised and the cost of funding decreased in 2019 as EIBOR trended lower and the UAE Central Bank cut its benchmark interest rate by 75 basis points over the course of the year to 2.00%, imitating the cuts made by the US Federal Reserve. These factors have been supportive for the lending environment; however, banks and other loan market participants (particularly in the project finance space) remain cautious and we have continued to see 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 2020. We also note that, as of the time of writing this chapter, geopolitical tensions between the United States and Iran have arisen, which has the scope to impact the UAE and the region more broadly.

We also note that the Accounting and Auditing Organisation for Islamic Financial Institutions has introduced guidance that deems *Murabaha* structures as they are currently used in the market to no longer be *Shari'a*-compliant. This guidance became effective from 1 January 2020; consequently, we noticed that banks were making a concerted effort to close *Murabaha* transactions before the turn of the decade. As the *Murabaha* structure is very common, we expect banks will adopt alternative *Shari'a*-compliant structures; however, it is yet to be determined which structure will fill the void left by the *Murabaha* structure.

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). 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. 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 systems.

Practitioners should also be aware that *Shari'a* (Islamic law) is a main source of legislation as confirmed by Article 6 of the Constitution of the UAE 1971, as amended ("UAE Constitution"), and 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", "interest" 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", "profit", "facility" or "financing", as applicable.

Legislation

A new 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), introducing a value added tax ("VAT") at a rate of 5% across the UAE as of 1 January 2018. As a consequence, facility agreements now must contain provisions regulating the payment of VAT by the borrower. Lenders and borrowers also need to assess the applicability of VAT to commodity trades used in commodity *Murabaha* financings.

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 was 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 its untested nature, we have seen circumstances where parties have erred on the side of caution and have chosen to take security under both 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 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".

The DIFC also introduced a new insolvency law (DIFC Law No.1 of 2019) (the "New DIL"), which came into effect on 6 May 2019 and adopts the UNCITRAL Model Law, in order to facilitate cross-border cooperation for multijurisdictional insolvency proceedings.

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 Mohammed 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. The purpose of the guarantee must be clearly defined from the outset as per the laws of the UAE.

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. 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 Part 9 of the ADGM Companies Regulation 2015 (the "ADGM Companies 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 Companies 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 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. It should be noted that the relevant DIFC and ADGM laws also include provisions to protect third parties dealing with companies in good faith. For example, Article 21 of the New DCL and Article 35 of Part 4 of the ADGM Companies Regulations both state that a person acting in good faith shall not be affected by any limitations in the articles of a company relating to the ability of the directors to bind the company. This approach is broadly consistent with the UK Companies Act 2006.

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"), the DIFC Security Regulations, the DIFC Financial Collateral Regulations and the 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 Companies 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 machinery and shares, whereas a floating charge usually covers all other current and future assets, including stock-in-trade, and a mortgage would typically be taken over land. 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).

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 the 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 permit 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 the 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.

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 Companies 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 Companies 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 have 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).

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 a security interest 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 depending on the document that is to be notarised. For example, notarisation fees for a share pledge agreement are approximately AED 1,300.

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 fees vary among 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 subject to a minimum cost of USD 250 and a maximum of USD 5,000.

In relation to the ADGM, the application to register a mortgage is charged at 2% of the principal amount of the value secured by 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 that are listed on an exchange such as the DFM, the consent of the Clearing Settlement and Depository division of the DFM (the "CSD") may be required. The CSD may also request certain documents to be provided before giving such consent. Further, any security against government-owned assets will require consent from the Department of Finance or the Supreme Fiscal Committee, as applicable.

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 requirements 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. 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.

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. 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

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 assistance prohibition will not apply to LLCs.

Offshore

For DIFC, a public company and its subsidiary 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 the DIFC Company Regulations (2018) as exempt.

In relation to the ADGM, Chapter 2 of Part 17 of the ADGM Companies 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 Companies 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?

Onshore

In the UAE there is no concept of a trust as is commonly the case in civil law systems; however, the concept of agency exists. Syndicated loan transactions will typically involve the appointment of a security agent that is responsible for holding and enforcing security on behalf of the relevant syndicate of lenders. It is best practice for the security agency agreement that appoints the relevant security agent to include parallel debt provisions to ensure that each lender retains the ability to enforce directly against the borrower.

Additionally, it is important to note many forms of security may only be granted to banks licensed by the UAE Central Bank (for example, the DED will only register share pledges in favour of banks licensed by the UAE Central Bank). It is also important to note that certain assets may only be able to be held by a UAE national or a UAE incorporated entity due to foreign ownership restrictions (subject to the FDI Law).

Offshore

The DIFC and ADGM are a mix of common law and civil law systems, and both recognise the concepts of trust and agency. As such, a security trustee or a security agent may enforce security on behalf of a syndicate of 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?

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?

Provided that the transfer of the loan from Lender A to Lender B is effective and perfected, there should be no additional requirements to make the loan enforceable by Lender B. Under UAE law, there is no concept of novation; however, assignment of both obligations and benefits under a contract is permissible. By contrast, the DIFC and ADGM recognise the concept of 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?

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 originally planned to introduce VAT in 2019; however, reports suggest that VAT will not be introduced until 2021 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, service charges and housing fees.

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).

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, Singapore, Australia and both the Commercial Court and Queen's Bench Division of the Courts of England and Wales (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 up 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 generally 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) a member's voluntary liquidation; (iv) a creditors' voluntary liquidation; (v) receivership; and (vi) compulsory liquidation. Additionally, the New DIL also provides for rehabilitation, which allows a company to submit a rehabilitation plan, provided there is a reasonable likelihood of such plan being successful and the plan is agreed upon by the company's shareholders and creditors.

The New DIL governs insolvency proceedings in the DIFC. The New DIL allows the DIFC Courts to grant a moratorium, including in relation to the enforcement of collateral, to an eligible applicant. Part 3 of the New DIL also provides for an automatic moratorium (typically for 120 days) in situations where the directors of a DIFC company have notified the DIFC Court in writing that they intend to propose a rehabilitation plan to the creditors of the relevant company.

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 New DIL 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 three months' wages or salary.

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 New DIL 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 apply 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, Article 247 of the Code of Civil Procedures 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 or not 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, the DFSA, under DIFC Law No. 1 of 2004 (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 AED 50,000,000 (in accordance with section 232 of the Financial Services and Markets Regulations 2015 and Article 23 of Abu Dhabi Law 4 of 2013).

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 that 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:

A Reversal in Rising Interest Rates

The trend of rising interest rates that began in late 2015 and continued through 2018 saw a reversal in 2019, as the Federal Reserve slashed the federal funds rate three times over the course of the year. The Federal Reserve's decision to lower its benchmark rate stemmed from general concerns about the current administration's views towards China with respect to trade and growing fears that a global economic slowdown may loom on the horizon. This move from the Federal Reserve departs from its prediction at the end of 2018 that the trend of rising interest rates would continue into 2019. Instead, the Federal Reserve decided to hold the federal funds rate steady at 2.25% to 2.50% through July 2019 before cutting the rate three times in August, September and October, ending the year at a benchmark rate of 1.50% to 1.75%.

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, and remained prevalent in leveraged lending transactions during 2019. 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. This trend appeared to continue through 2019, as total leverage on institutional middle market deals topped out at 5.98×, its highest annual level since the financial crisis. Likewise, federal regulators in 2019 issued a final rule to amend aspects of the "Volcker Rule", impacting CLO managers and banks that structure, warehouse and make markets in CLOs. The initial 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. The new rule amending the Volcker Rule, published November 14, 2019, creates a three-tiered compliance regime based on the value of the trading assets and liabilities held by a banking entity. Moderately sized banking entities (between \$1 billion and \$20 billion of trading assets and liabilities under management) are subject to simplified compliance requirements, and entities with limited trading assets and liabilities (less than \$1 billion) are presumed to be in compliance with the Volcker Rule. The willingness of federal regulators to amend 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 continue 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.

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.)

Replacement of LIBOR as the Benchmark Rate

With LIBOR scheduled to be phased out as the global benchmark rate at the end of 2021, lenders in the US have begun to seek an alternative benchmark rate to replace LIBOR. One such rate garnering attention in the US loan market is the Secured Overnight Financing Rate, or SOFR, which is calculated based on the overnight rates offered on the Treasury repurchase market. On October 9, 2019, in an effort to provide guidance on the potential knock-on effects of replacing LIBOR with an alternative benchmark rate like SOFR, Treasury published proposed regulations to address the potential adverse tax consequences of incorporating LIBOR-replacement language into existing loan documentation. In general, these proposed regulations seek to limit the circumstances in which replacing LIBOR with an alternative benchmark rate could result in a deemed exchange of the subject debt instrument, which could have adverse consequences. These regulations are proposed to apply to transactions taking place on or after the date the final regulations are published. However, taxpayers generally may rely on the proposed regulations provided that the taxpayer and any related parties apply the proposed regulations in a consistent manner.

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 grow in popularity in 2019 (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). 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 Direct 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. However, the pull back of the Leveraged Lending Guidance, did not shift the needle back in the direction of traditional banks in 2019, as Direct Lenders continued to grow market share as compared to traditional banks throughout the course of the year on middle-market deals.

Litigation Finance. While originally developed in Australia and the United Kingdom, the business of litigation finance has gained significant traction in the United States. Investors are drawn to this asset class given its attractive returns that are "not correlated to the market". The two most common types of litigation finance include (a) providing funds to a plaintiff in exchange for a commitment to receive a share of the award or settlement resulting from litigation, and (b) providing funds to a law firm in exchange for a portion of the fees the law firm may receive from its contingency cases. Such financing is typically limited recourse, meaning the investor is only repaid if the plaintiff (or law firm) wins an award. Investors can realise significant returns, usually based on "multiples" of their initial investment or a "percentage" of the overall proceeds realised. Litigation finance has its share of critics: some lament "turning the court system into a stock exchange", while other observers argue litigation finance provides "access to justice" by "leveling the playing field" when parties in litigation have unequal financial positions. The law surrounding litigation funding is unsettled and changes rapidly. While regulatory scrutiny is on the rise, the asset class seems destined for continued growth for the foreseeable future given the surge in investment and the fact that it has established itself as a very useful tool for a variety of market participants.

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*: Calpine Corporation (August 12, 2019) and Callaway Golf Company (January 4, 2019); *Equity Cures*: Cerence Inc. (October 1, 2019) and SciPlay Holding Company, LLC (May 7, 2019); *Builder Baskets*: Revlon Consumer Products Corporation (August 6, 2019) and Kontoor Brands, Inc. (May 17, 2019); *Unrestricted Subsidiaries*: PHI Group, Inc. (September 4, 2019) and Del Frisco's Restaurant Group, Inc. (June 27, 2018); *Incremental Facilities*: Diamond Sports Group, LLC (August 23, 2019) and MoneyGram International, Inc. (June 26, 2019); and *Reclassification:* Constellation Brands, Inc. (June 28, 2019) and iHeartCommunications, Inc. (May 1, 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)?

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 will not likely be voided as a fraudulent transfer). Solvency will be determined by the application of a variety of tests, such as the cash flow test, which examines the guarantor's ability to meet its projected debt obligations as such obligations fall due, and the balance sheet test, which examines whether the guarantor still has enough assets to cover its liabilities at a fair valuation. 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 void such guarantees under state law 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 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 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 interests 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 the 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?

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 being 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 voluntarily initiated by a company, or a company's creditors may initiate a bankruptcy filing in light of accrued and unpaid debt, creating an involuntary bankruptcy. Once a proceeding has commenced, the Bankruptcy Code provides that an "automatic stay" is automatically implemented. This automatic stay is effectively a court order that prevents creditors from taking, or continuing to take, any actions against the debtor or property in which the debtor has an interest, 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). A creditor, however, may seek relief from the automatic stay by filing a motion with the bankruptcy court.

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, in the case of a reorganisation of a debtor, cash collateral cannot be used by a debtor without the consent of the secured party or authorisation from the bankruptcy court. The bankruptcy court may require that a debtor provides "adequate protection" to preserve the value of the secured creditor's interest in any property being used by a debtor—for instance, a debtor may be required to issue additional or replacement liens or make periodic payments to the secured creditor. Upon a liquidation of a debtor, a secured creditor will be 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.

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 a hypothetical liquidation of the debtor. There are a number of exceptions to this rule, including where there has been a substantially contemporaneous exchange, an exchange for new value, or where the transaction involves a purchase money security interest. Please also see the discussion of "fraudulent transfers" in question 2.2. There are also certain claims that may have priority even over a properly perfected security interest, including tax liens, mechanics' liens, 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 certain banks, insurance companies, railroads, commodity brokers, stockbrokers and government entities and 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?

Yes. Outside of bankruptcy, 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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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, in the recent past, was 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?

An exchange control was legally in effect from 2003 to 2018. 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 infusions of foreign currency administered by it. 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 interests 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 realising 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 net worth 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 stops 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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